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EMPLOYEE PENSION PROTECTION ACT OF 1989

HEARING

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 685

TO AMEND TITLE I OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 TO CLARIFY THE APPLICABILITY OF RULES RELATING TO FIDUCIARY DUTIES IN RELATION TO PLAN ASSETS OF TERMINATED PENSION PLANS AND TO PROVIDE FOR AN EXPLICIT EXCEPTION TO SUCH RULES FOR EMPLOYER REVERSIONS MEETING CERTAIN REQUIREMENTS

APRIL 11, 1989

Printed for the use of the Committee on Labor and Human Resources

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EMPLOYEE PENSION PROTECTION ACT OF 1989

TUESDAY, APRIL 11, 1989

U.S. SENATE,
SUBCOMMITTEE ON LABOR
OF THE COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:01 a.m., in Room SD-430, Dirksen Senate Office Building, Senator Howard Metzenbaum (chairman of the subcommittee) presiding.

Present: Senators Metzenbaum and Jeffords.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. Good morning.

Today the subcommittee will consider S. 685, the Employee Pension Protection Act of 1989. Two months ago, this subcommittee held a hearing on the problem of pension plan raiding by employers who seek to recapture so-called "excess" pension assets. At that time, I stated my intention to introduce legislation that would protect workers' fair share of pension assets. I asked all interested parties to work with me.

Over the past two months, I have listened to the views and concerns of everyone who came forward. The Employee Pension Protection Act is the result of that process.

Several times, Congress has come close to enacting legislation to protect workers' retirement benefits from pension plan looting. Several times, we have failed to protect workers, and more billions have gone out the door.

Last fall, the Treasury Department agreed to suspend termination approvals until May 1st. But workers need a permanent solution. We need a solution to keep all of those dollars that are scheduled to go out the door as of May 1st before that time.

As these charts show, since 1980, 2,000 plans have been terminated; 2 million workers have watched their employers run to the bank with $20 billion. At least 600 plans are being held up by the Treasury Department suspension. Congress must act before May 1st or the Administration must cause an additional delay.

I hope it is fair to say that all of us here today care about good pension policy. Given the continuing pressure to contain Social Security, the need for a private pension system that provides secure and adequate retirement benefits becomes more and more important.

But increasingly, employers are running away from their pension promises. The merger and takeover mania of recent years has turned pension plans into sources of easy cash instead of savings for retirement. This is not good pension policy.

The law should not encourage employers to strip out money set aside for retirement benefits.

The Employee Pension Protection Act seeks to redress this weakness in the law. The bill has three goals. First, to protect workers' fair share of the money set aside for retirement. Second, to encourage employers who terminate plans to set up new plans, as generous as their former ones. Finally, by more fairly protecting workers' pensions, to reduce the incentive to use pension assets to finance a merger or a takeover.

Under the bill, the amount of excess assets an employer may recover depends upon the type of new plan the employer establishes. It is right and proper that the kind of new plan the employer establishes should be partially determinative of how much the employer can take out.

If the employer establishes a complete replacement plan—an identical defined benefit plan—a cushion of 25 percent of projected benefits must be kept in the new plan, and a one-time inflation adjustment provided to retirees. Any remainder may be recovered by the employer.

If an employer sets up a substantial replacement plan, a less generous plan, a cushion of 35 percent of projected benefits must be kept in the new plan, and a one-time inflation adjustment provided to retirees.

If the employer fails to set up even a less generous plan, the 35 percent cushion and any remainder go to the active workers and a one-time inflation adjustment is provided for retirees.

Employers should not be able to recapture pension assets when they are wholly abandoning their pension promise.

The structure of this bill takes into consideration the impact of numerous actual terminated plans, as well as model plans. The following chart illustrates that in three companies—Enron, Cities Service and FMC—the employer would still have recovered between 24 and 59 percent of the excess assets after protecting workers. In some of the plans that were terminated before 1989, the employer would not have recovered anything. But there are other plans in which the employer would have recovered as much or more than the percentages here.

I have worked long and hard to craft a bill that protects the interests of both workers and employers in excess pension assets. May 1st will soon be upon us, so I intend to move quickly to pass this bill. I am a realist about the challenges that lie ahead, but we must ensure that our national pension policy protects workers' retirement benefits.

My door is open to those who have a concern about this legislation. I am not prepared to sit here and say that we have crafted a 100 percent perfect plan. I am prepared to say that this is an issue that has deserved Congressional attention over a period of many years, and it is time that we move on it. If the proposal that I have made is not the perfect proposal, our door is open, and we are willing to reason together with those who have a concern about this subject.

[Additional material of Senator Metzenbaum follows:]

SUMMARY OF THE EMPLOYEE PENSION PROTECTION ACT (S.685/H.R. 1661)

introduced by Senator Metzenbaum and Representative Clay

The Employee Pension Protection Act seeks to:

1) protect workers' retirement benefit security by ensuring that they receive their fair share of pension plan assets if their plan is terminated; and
2) encourage employers that terminate their pension plans to establish new plans as generous as the terminated ones.

Under the bill:

An employer must terminate the pension plan and vest all benefits earned up to the date of termination (same as current law).

If the employer establishes a complete replacement plan (an identical defined benefit pension plan), the plan must:

1) retain a cushion of 125% of projected benefit liabilities in the new plan to protect the promised benefits of active workers and to protect against a stock market downturn;
2) provide a one-time increase to retirees to the extent their benefits have not been adjusted for inflation in the past;
3) then, permit an employer to recoup any remaining assets if in accordance with the terms of the plan.

If the employer establishes a substantial replacement plan (a less generous defined benefit or defined contribution plan), the plan must:

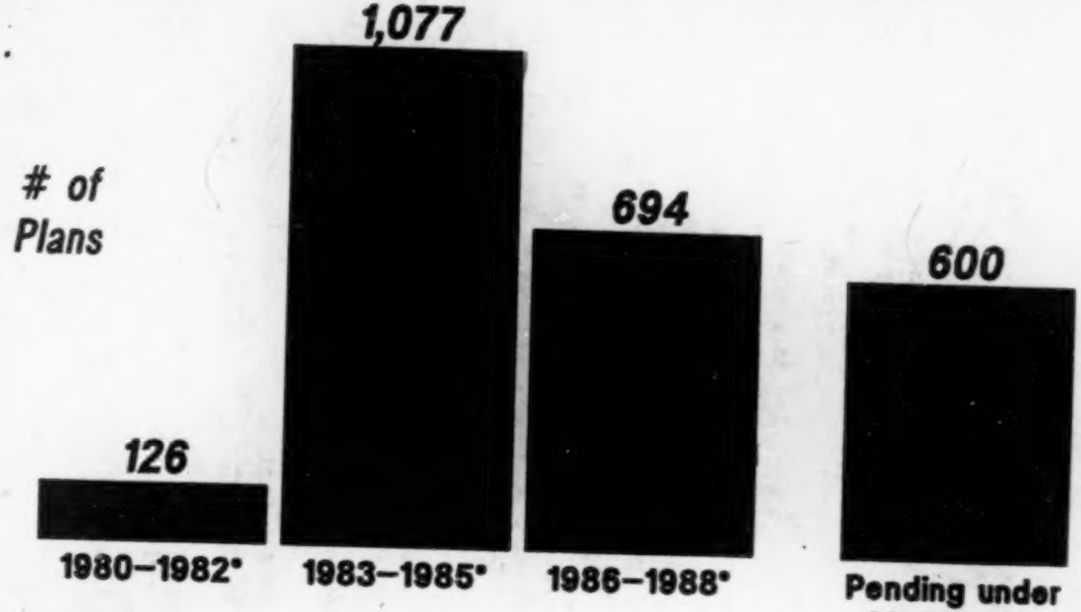
1) meet certain minimum standards (to ensure it's not a sham plan;
2) transfer a cushion of 135% of projected benefit liabilities into the new plan to protect the promised benefits of active workers, to protect against a stock market downturn and to compensate for the additional loss in workers' retirement benefits;
3) provide a one-time increase to retirees if they have not received inflation adjustments in their benefits in the past; and
4) then, permit an employer to recoup any remaining assets if in accordance with the terms of the plan.

If the employer does not establish a new plan or establishes a sham plan, the plan must:

1) allocate the 135% cushion to the pension benefits of active workers;
2) provide a one-time increase to retirees if they have not received inflation adjustments in their benefits in the past; and
3) allocate any remainder to the pension benefits of active workers on a pro rata basis.

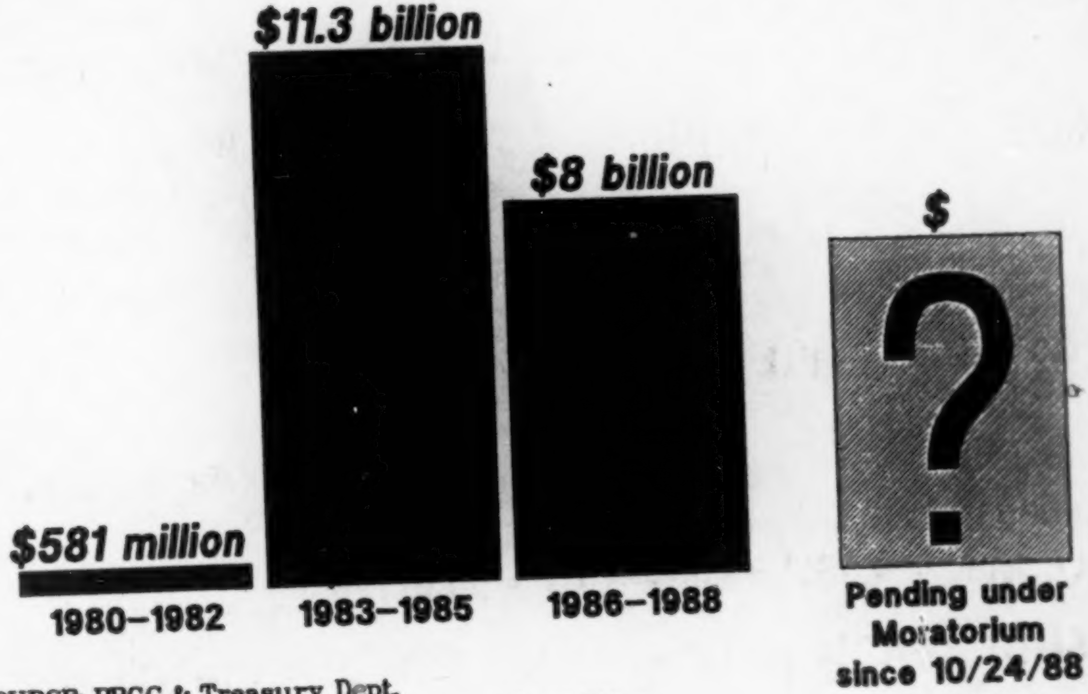
Insert w/ addendum for the record

Number of Pension Plan Terminations with Employer Asset Reversions



SOURCE: PBGC & Treasury Dept.
* Data available only for reversions over $1 million

Pension Assets Recaptured by Employers



SOURCE: PBGC & Treasury Dept.
* Data available only for reversions over $1 million

Impact of S. 685, the Employee Pension Protection Act on 3 Actual Reversions

	Enron (1986) (energy)	Cities Service (1983) (oil)	FMC (1985) (chemicals)
Under Current Law:			
Employer Reversion	$232 mil	$233 mil	$726 mil
Under S. 685:			
New plan for active workers (with 25% cushion)	31%	60%	50%
One-time inflation adjustment for retirees	10%	13%	26%
Employer Share	59%	27%	24%

Source: Independent Actuarial Calculations based upon Department of Labor form 5500 data.

Senator **Metzenbaum**. We are looking forward to hearing from our witnesses today.

I must say that I am a little bit sorry that we are not hearing from more of the business community. It was not because the opportunity was not present. We will hear from benefits counsel of Textron, Inc., on behalf of the ERISA Industry Committee, but I had hoped that we would hear from some individual corporation spokespersons as well.

Our first panel consists of Arthur Wilson, President of Local 8-898, Oil, Chemical and Atomic Workers, of Christiana, Delaware, and Fred Kelso, of Trenton, New Jersey.

Each of the witnesses is limited to five minutes for their presentation, and their entire written statements will be included in the record.

Mr. Wilson and Mr. Kelso, would you be good enough to come forward, please?

Mr. Wilson, please proceed.

STATEMENTS OF ARTHUR WILSON, PRESIDENT, LOCAL 8-898, OIL, CHEMICAL AND ATOMIC WORKERS INTERNATIONAL UNION, CHRISTIANA, DE; AND FRED KELSO, TRENTON, NJ

Mr. **Wilson**. Good morning. I am Arthur Wilson, and I am President of Local 8-898 of the Oil, Chemical and Atomic Workers.

My Local Union represents some 375 employees at the Delaware City refinery formerly owned by Getty Oil, now owned by Texaco. I have been employed there, Senator, since 1962.

I would like to begin my remarks this morning by telling you how pleased we are that you and the other esteemed members of your committee are determined to end what has so far amounted to a $19 billion ripoff of working men and women in this country.

Getty Oil was purchased by Texaco in 1984. In December of that year, Texaco announced a restructuring of the pension plan for the Getty Oil employees. On December 31st, the assets were spun off, and Texaco stole over $250 million from the Getty Oil employees' plan.

Texaco then proceeded to use the money of 18,739 former Getty Oil employees to pay for the Pennzoil lawsuit and a proxy fight with Carl Icahn—no improvement in employees' standard of living has resulted.

The theft of our pension fund assets amounted to nothing more than a transfer of income from the working class to the fat cats of Wall Street.

At the time of the 1984 termination-spinoff, the takeover of Getty Oil was under investigation by the FTC. Because of this investigation, Texaco was mandated to maintain Getty's benefit levels until 1986. On March 1, 1986, Texaco discontinued the Getty plan altogether, invested active former Getty employees in the Texaco plan. Texaco then purchased annuities which are to provide the appropriate amount of pension earned and due each of us at age 60 from the Getty plan. The annuities have no provision for cost-of-living adjustments, and no adjustments have been provided to former Getty employees who have retired since December 1, 1984.

This is in contrast to a series of adjustments that had been given by Getty Oil prior to 1984.

Now, you have heard similar stories before, but today, Senator, I would like to tell you how asset reversions have continued to affect my active members.

Texaco's pension plan formula provides a smaller pension than the Getty plan did for identical service and pay class. Texaco acknowledged this and advised that all former Getty employees, upon retirement, would receive either the "more generous" of the two amounts—that provided for by the annuity from the Getty plan—or the amount that the Texaco plan formula generated, whichever was greater.

Let me give you an example of this reduction in benefits from the actual experience of a continuously employed member of my Local.

"Frank" was employed at the Delaware Refinery by Getty Oil in August of 1959. In March 1986, Frank had 26½ years of service and earned a pension due of $1,065 per month at age 60 from the annuity in the Getty plan.

Frank plans to retire as of March 1, 1992 and inquired of Texaco regarding what his total pension would be on that date. Company representatives have advised that the Texaco pension plan formula would provide income of $1,038 per month for Frank's then 32½ years of service at age 62. This amount is $27 per month less than the amount of his Getty benefit accumulated as of March 1986. The end result is that Frank, along with the other former Getty employees, although continuously employed at the same locale, will have worked for six years without accumulating any additional pension benefits despite being fully vested and in a qualified pension plan.

Now, while it might seem that the Texaco-Getty reversion was a one-time occurrence, Senator, it has continued to have adverse effects on my members.

In our case, the Texaco plan is actually being subsidized by the former Getty Oil employees since, under Texaco's method of calculation, which subtracts the Getty Oil plan annuity, we will earn no additional benefits for our years of service between 1986 and 1992.

When we first became aware of this inequity, we wrote to Texaco Corporate Employee Relations Department and asked that some of the excess funds from the Getty plan be used as a supplement in order to maintain the level of pension benefits Getty Oil employees would have received had there been no reversion. Texaco officials replied that such treatment was simply not financially feasible.

To add further insult to injury, the Delaware Refinery has now become part of a new company, Star Enterprise, a joint venture between Texaco and Saudi Arabia. We have been told that we will no longer be covered by the Texaco plan, but instead covered by another new plan, effective January 1989.

Inasmuch as we have no pension due from the plan in which we have been vested for the last several years, and inasmuch as Texaco has accumulated no pension liability to us, we can expect Texaco to once again raid our pension plan.

If the Employee Pension Protection Act is not promptly enacted, monies—which Texaco stated they were contributing at a rate of

42½ cents an hour toward our financial security—will again be declared excess and put to use for other purposes.

Senator, this amount of theft will be just under $1 million for the OCAW-represented employees in the Delaware City refinery alone.

Our original employer, Getty Oil, routinely referred to our pensions as part of a second paycheck. Our pensions were not a gift—they were deferred compensation paid for from our current wages at the bargaining table. Corporations must not be permitted to continue to steal these monies back with callous and wanton disregard for workers and retirees the funds were originally set aside for. This is not a victimless crime.

The Employee Pension Protection Act will help provide the retirement security that the working class of America has earned by reducing the jeopardy from reversions, and in turn, will free us from dependence on the Federal Government for adequate income during our retirement years.

In conclusion, Senator Metzenbaum, I want to commend you and the members of this committee for your continuing concern for the pension rights of both active and retired employees. The sincerity of your effort is most appreciated by workers all over our great country.

Thank you.

Senator METZENBAUM. Thank you very much, Mr. Wilson.

Mr. Wilson, when the company reduces that which the employees thought they had coming, and the employees have put in 20, 25, 30 years, do you think that there is a little lessening of the enthusiasm and the drive to do a good job for the company than otherwise would be present? Is there not some loss of esprit de corps and the drive to do the job better?

Mr. WILSON. Most certainly, Senator. The reason for staying in a particular location obviously was over a period of time, we determined that we would accumulate some benefits in our retirement years. This caused us to have loyalty to that particular company. We had a lot of faith in Getty Oil Company that they were going to provide for our future. And obviously, it has affected our productivity because we have become discouraged. We are no better off today, sir, than if we had quit in 1986 and went to work for a fast food chain.

Senator METZENBAUM. So you went from working for Getty; then you wound up working for Texaco; now you work for Texaco and a Saudi Arabian Company?

Mr. WILSON. I work for a totally new company as of January 1989, called Star Enterprise, and that is a spin-off, joint venture between Texaco and the country of Saudi Arabia, yes, sir.

Senator METZENBAUM. Is it the country of Saudi Arabia itself that is the partner, or is it a corporation?

Mr. WILSON. It is my understanding that it is a corporation.

Senator METZENBAUM. Prior to the termination of the pension plan, did the employees think that the assets in the plan were being held solely to provide for retirement benefits for them?

Mr. WILSON. Yes, that was our understanding, sir.

Senator METZENBAUM. Now, did the union have any representation on the pension plan board?

Mr. WILSON. No, sir, we did not.

Senator **Metzenbaum**. It was solely operated by the corporation.

Mr. **Wilson**. That is correct.

Senator **Metzenbaum**. The argument is often made, well—what are you complaining about? This is just a gift that you are getting.

The counter-argument has been that unions and employees accept lower wages in exchange for having money contributed to a pension plan. Can you give us any advice on that?

Mr. **Wilson**. Yes, Senator. The company routinely furnishes me with the cost per hour of benefits for my Local Union, and in this case they recently acknowledged that the cost of benefits for the pension itself is 42½ cents an hour. It stands to reason that if it only cost 30 cents an hour, we could have used the 12 cents for some other benefit, yes, sir.

Senator **Metzenbaum**. Has the company given you any explanation as to why they terminated cost-of-living adjustments?

Mr. **Wilson**. No, they have not. And that has been one of the big disappointments, sir. Getty had routinely given cost-of-living adjustments over a long period of time, and we had come to have faith that these adjustments would continue, at their discretion, of course, but nonetheless their past performance had indicated that they would continue.

Texaco has given no adjustments at all to the Getty employees who have retired since the plan spin-off, and that has been some four years now.

Senator **Metzenbaum**. Thank you very much, Mr. Wilson. Your testimony has been very helpful.

Mr. **Wilson**. Thank you, Senator.

Senator **Metzenbaum**. Mr. Kelso, we are happy to have you with us here today, sir. Please proceed.

Mr. **Kelso**. Thank you, Mr. Chairman and members of the Labor Subcommittee.

My name is Fred Kelso. I am a 68-year-old retiree from Ewing, which is a suburb of Trenton, New Jersey.

I feel honored to appear before you today to share my views on corporate raids on pension plan. My company, the FMC Corporation, raided my plan of hundreds of millions of dollars. Meanwhile, I and other retirees are left to live on pensions which are worth less and less every year.

I worked for FMC for over 27 years in California and New Jersey as a chemical engineer in production plans and research and development, becoming an Assistant Research Director in Charge of Engineering. I not only expected a pension for all my years of work, but had expectations of cost-of-living increases as well, which have been given periodically over the years to retirees.

But in late 1987, just weeks before "black Monday", FMC Corporation raided my plan of some $700 million. What did they do with this money? They did not use it to improve benefits for active workers, or provide necessary cost-of-living adjustments to retirees whose benefits had been continuously eroded by inflation. They used it for shark repellents, poison pills and golden parachutes, and to recapitalize the company to repel a raid by Ivan Boesky.

I thought pension plans existed to provide adequate pensions for retirees, not as a corporate financing tool. I accepted less salary while working so I could get a pension later on—a pension I assumed would be adequate. If the money put in for me and other retirees has risen in value because of a sky-high stock market, why doesn't it make sense that some of that increase should be passed on to retirees? Otherwise the pension plan actually makes a profit at our expense.

Even in the seven years since I have retired, prices have gone up steadily. Yet our pensions have stayed at a fixed amount. For older retirees, those who have been out 10, 15 or more years, the impact is getting to be tremendous.

In the past, FMC recognized the impact of inflation, and did give adjustments. I assumed this practice would continue when I agreed to take early retirement. But once the plan was raided, my pension was annuitized, and any hope of adjustments disappeared.

The FMC Chairman justified this action by saying, "I want to assure you that your retirement benefit will not change as a result of this action. The only change will be that your retirement check will be issued by an insurance company." Yes, we continue to get a check, but it does not come through an insurance company, even though it is the second year since the plan was raised; it still comes from FMC headquarters in Chicago. The amount on the check decreases in value every year.

I do want to say I have tried to stop this reversion in every way I could. Eleven of us signed a letter to the Department of Labor, protesting the FMC move, and we have individually written to the Internal Revenue Service in Chicago and to our representatives and Senators in Congress. I testified before the ERISA Advisory Council's Task Force on Terminations in March 1987.

I come here today to protest the continued ripoff of retirees by companies in every field of industry. Personally, I am not going to get any increase in my own pension, even if the laws and their interpretation and enforcement are changed. The money in my pension plan is gone; it has been dissipated.

The $700 million surplus in the FMC trust has gone away. It may be instructive, however, to see what great purposes it was used for. On the last day of 1986, the annual report says the plan assets were $1.43 billion, and the plan liabilities were $798 million. The surplus was $636 million, or 80 percent more than the liabilities. To my simple-minded way of looking at it, this says they could have raised our pensions, pensions earned to all current employees, by 80 percent.

I am told the withdrawal was about $700 million, but FMC in their 1987 annual report claimed $333 million. I do not know how to explain this large discrepancy, other than to say it could be some "creative bookkeeping."

But consider the following facts. There was a 10 percent tax penalty. The insurance companies, I am sure, plan to make a profit on taking over the FMC account—more than just covering their actual expenses. The IRS told me that this was a "participating annuity", which was a new term to me. They explained it as follows, that the insurance company assumed we would make 7, 7½ percent on the assets we take over to pay off all the liabilities. Now, if they make more than this, FMC gets cut in on part of this additional income. But they have to pay for this. I do not know how much they pay. It is hard for me to reconcile such an abuse of pension trust dollars with a statement in the trust document that says, "All pension moneys are to be used solely for the benefit of retirees."

In 1986, FMC recapitalized its structure. This included taking on about $1.5 billion in debt, increasing insiders' share of the common stock from about 18 percent to over 35 percent, which has since been increased by stock repurchases. The common stock dividend had been paid continuously for many, many years, but as a result of this action it was eliminated, and no resumption is in sight.

This horror story—at least it is for the retirees—is all too typical of what is happening today. Something has to be done to ensure that retirees receive a substantial part of pension trust surpluses to compensate for continual increases in cost-of-living. Otherwise, all too many of the retirees will be faced not with their "golden years", but with their public welfare years.

I have talked and complained and protested, but so far to no avail. I hope, Senator, that your committee will pass the Employee Pension Protection Act and help the millions of retirees and workers whose pension plans have not yet terminated.

What the legislation would have meant to me is that before FMC could take back $700 million, it would first have had to provide a one-time cost-of-living adjustment to restore the purchasing power of my pension.

Thank you for your interest and attention. I have enjoyed giving you my views on this important subject, and I hope it will help you in your deliberations. I will be glad to answer any questions you have or to comment further if you wish.

[The prepared statement of Mr. Kelso follows:]

STATEMENT OF
FRED KELSO
BEFORE THE
SENATE SUBCOMMITTEE ON LABOR

Mr. Chairman, Members of the Labor Subcommittee, my name is Fred Kelso and I am a 68 year old retiree, from Ewing, New Jersey. I feel honored to appear before you today to share my views on corporate raids on pension plans. My company, the FMC corporation, raided my plan of hundreds of millions of dollars. Meanwhile, I and other retirees are left to live on pensions worth less and less every year.

I worked for FMC for over 27 years in California and New Jersey as a chemical engineer in production plants and research and development, becoming an Assistant Research Director in charge of Engineering. I not only expected a pension for all my years of work, but had expectations of cost-of-living increases as well, which have been given periodically over the years to retirees.

But in late 1987, just weeks before Black Monday, FMC Corporation raided my plan of some $700 millionn -- an awesome figure indeed. What did they do with the money? They didn't use it to improve benefits for active workers, or provide necessary cost of living adjustments to retirees whose benefits have been continuously eroded by inflation. They used it for shark repellants, poison pills and golden parachutes and to buy back stock to repel a raid by Ivan Boesky.

I thought pension plans existed to provide adequate pensions to retirees, not as a corporate financing tool. I gave up salary while working, so I could get a pension later on -- a pension I assumed would be adequate. If the money put in for me and other retirees has risen in value because of a sky-high stock market, then doesn't it make sense that some of that increase should be passed along to retirees? Otherwise the pension plan actually makes a profit at our expense. The plan invests our money, getting a return in current dollars, while paying us in devalued dollars. Is this really "surplus?"

Even in the seven years since I've retired, prices have gone up steadily. Yet our pensions have stayed at a fixed amount. For older retirees, those who've been out 10, 15 years, the impact would be tremendous.

In the past, FMC recognized the impact of inflation, to some extent, and occasionally gave adjustments. I assumed this practice would continue when I agreed to take early retirement. But once the plan was raided, my pension was annuitized, and any hope of adjustments disappeared.

The FMC Chairman justified this action by saying, "I want to assure you that your retirement benefit will not change as a result of this action. The only change will be that your retirement check will be issued by an insurance company." Yes, we continue to get a check from FMC. But the amount on the check decreases in value every year.

And how protective is this insurance annuity? What would happen if there should be a less favorable economic climate, which seems inevitable, and my insurance company goes bust like Baldwin United. How are we protected and by whom?

When the pension plan was operating, we had the safeguards of the Pension Benefit Guaranty Corporation. Would the PBGC still insure my benefits now that it is covered by an insurance company? Is the carrier controlled by the PBGC and other federal laws or only by the insurance laws of their state of incorporation?

The net result of all these factors is that my annuity is now backed by less assets, and by fewer guarantees and safeguards. We were sold, not to the highest bidder, but to the lowest bidder, the insurance company who will put the lowest net present value on our lifetime pension payments.

I have to say, I tried to stop the transaction in every way possible. Eleven of us signed a letter to the Department of Labor protesting the FMC move, and we have individually written to the Internal Revenue Service in Chicago and to our Representatives and Senators in Congress. I testified before the ERISA Advisory Council's Task Force on Terminations in 1987.

I have talked, and complained and fought and protested --

to no avail. Now I hope that the Employee Pension Protection Act will finally pass and help the hundreds of thousands of retirees and workers whose pension plans have not yet been terminated. What the legislation would have meant to me is that before FMC could take back hundreds of millions of dollars, it would first have had to provide a one-time cost of living adjustment to restore the purchasing power of my pension.

Thank you for your interest and attention. I have enjoyed giving you my views on this important subject and hope that they will help you in your deliberations. I will be glad to answer any questions you have or to comment further with any of you if you wish.

Fred J. Kelso

Senator Metzenbaum. Thank you very much, Mr. Kelso. Your testimony is very helpful to us.

Do you think that FMC fully delivered on its retirement promise to you?

Mr. Kelso. So far as the dollars per month are concerned, yes, sir.

Senator Metzenbaum. What you are saying is that they gave you the dollars per month that they were committed to give you, but do you feel that their failure to allow for inflationary increases was in some way a let-down of that which you had previously anticipated?

Mr. Kelso. That is correct. The chances of any future increases I think right now are zero, because the monies have been turned over to insurance companies.

Senator Metzenbaum. And as I understand it, those dollars that have been placed with the insurance company to provide the fixed annuities, the yield, if any, by reason of those dollars will redound to the benefit of the company and not to the benefit of those of you who are in retirement.

Mr. Kelso. As I understand it, the insurance company and FMC, by buying this participatory annuity, will share in any increase over what they had originally counted on.

Senator Metzenbaum. Did the workers have any say in the termination of the plan?

Mr. Kelso. No, sir.

Senator Metzenbaum. You retired in 1982?

Mr. Kelso. Correct.

Senator Metzenbaum. Offhand, do you know—I do not know—how much inflation has eaten into the value of your dollars between 1982 and 1989? I would have to guess 30, 35 percent.

Mr. Kelso. Over seven years, I would guess at least a third, yes.

Senator Metzenbaum. Well, thank you very much, Mr. Kelso.

As both of you have testified, you cannot help that which has already gone out the door, and your testimony here today is evidence of your concern for others who might be placed in similar circumstances.

Thank you very much.

Our second panel is Mr. Morton Bahr, President of the Communication Workers of America and Chairman of the AFL-CIO Subcommittee on Pension Termination and Reversions.

Mr. Bahr, we are particularly pleased to welcome you. I know you are engaged in negotiations of a major nature at the present time, so your being here with us is very meaningful and, I think, indicates the significance that CWA and the AFL-CIO place on this particular subject.

We are very happy to see you again, sir.

STATEMENT OF MORTON BAHR, PRESIDENT, COMMUNICATION WORKERS OF AMERICA, AND CHAIRMAN, AFL-CIO SUBCOMMITTEE ON PENSION TERMINATIONS AND REVERSIONS, WASHINGTON, DC, ACCOMPANIED BY MEREDITH MILLER AND ERNIE DuBESTER, AFL-CIO LEGISLATIVE STAFF

Mr. Bahr. Thank you very much, Senator.

I have with me Meredith Miller and Ernie DuBester of the AFL-CIO Legislative Department.

Senator **Metzenbaum**. We are happy to welcome them as well; they are familiar faces.

Mr. **Bahr**. Senator, as Chairman of the AFL-CIO Subcommittee on Pension Terminations and Reversions, I am pleased to have this opportunity on behalf of the AFL-CIO to express our support for S.685, the Employee Pension Protection Act.

We commend you, Mr. Chairman, and your colleagues for your longstanding commitment to seek permanent legislation that protects the pension rights of workers and retirees covered by terminated plans.

This issue is of utmost importance to many unions whose hard-earned pension fund assets constitute a major part of the $19.7 billion in employer reversions that have occurred since 1980.

Your initiative takes a major step toward stopping the wholesale looting by Wall Street raiders who cash out pension plans to finance corporate takeovers and by company executives who skim so-called "excess assets" when market values are high, leaving too thin a margin to meet pension obligations when values decline.

Your initiative addresses real problems that confront workers and retirees when plans are terminated and reversions are taken. Since several myths about this practice have been perpetuated, I would like to take this opportunity to address them before commenting on the legislation.

First, it is claimed that employers use pension fund assets in business deals that are designed to preserve workers' jobs or benefits. The fact is that use of pension fund assets in such deals frequently does harm to workers.

Since 1980, corporate mergers and acquisitions were responsible for the termination of 276 plans with $1.4 billion in assets reverting to employers for this purpose. In recent testimony before the House Ways and Means Committee, President Kirkland estimated that mergers, takeovers and leveraged buyouts over the past decade cost 90,000 union members their jobs.

Second, it is not true that most workers whose plans have been terminated and are covered by replacement plans are provided the same level of benefits as the original pension. Since 1986, the number of workers covered by a defined benefit replacement plan has steadily dropped from 75 percent to 43 percent in 1988. And one-fourth of all participants in terminations received no new plan in 1988.

Other benefit reductions result when annuities are purchased that are not indexed for inflation, when workers and retirees forego benefit improvements, and when the fund is stripped of assets to protect it against market downturns.

Study after study has shown that workers, not employers or the Government, bear the brunt of plan reversions. Put simply, the Department of Labor estimates that participants lose an average of 45 cents for every pension dollar they would have received if the plan had not been terminated.

The cases in which union members have been the victims of terminations are numerous. We have heard from Clothing and Textile Union members at the Reeves Brothers Textile Company whose pension plan was gutted and stripped of $27 million in pension fund "surplus" when Schick bought it out in 1986.

We have also heard from members of IUE Local 776 who are employed by Cincinnati Time. These folks lost their pension fund's "excess assets" when it was sold to General Signal Corporation, and they were forced to accept as a replacement an inferior 401(k) plan.

And today you heard from Art Wilson, President of OCAW Local 8-898. Art's story of the Texaco-Getty buyout and abuse of the workers' pension fund is one whose history is still being written.

The Employee Pension Protection Act which you have introduced, Mr. Chairman, would provide workers and retirees with specific benefit protections in cases of terminations and reversions before any assets revert to employers. The principle of sharing "excess assets" among workers, retirees, and employers to preserve the intent and functions of our retirement system is embodied in a statement unanimously adopted by the AFL–CIO Executive Council in February, and that statement called on Congress to prohibit unilateral employer appropriations of pension fund assets.

The statement, which I have attached to my testimony, also supports the legislation's provision that replacement pension plans should retain a cushion based on current projected benefits to safeguard against stock market downturns and inflation.

This requirement is vitally important to ensure the security and stability of pension benefits, and it is not too onerous a requirement to place upon plans. In fact, a recent study of Fortune 500 industrial pension plans conducted by Hewitt Associates indicates that 71 percent of plans surveyed were funded in excess of their projected benefit obligation.

We also support the one-time catchup for retirees whose pensions devalued by inflation have helped built the surplus in these "overfunded" plans. The Department of Labor found that in 1986, only 35 percent of workers participated in pension plans that had granted a cost-of-living increase during the previous five years.

The legislation's higher cushion and minimum benefit requirements in situations where a replacement plan provides less protection than the previous plan or involves conversion to a defined contribution plan provide an important safety net for workers. Nonetheless, where there is a defined contribution replacement plan, we believe the provision for a minimum employer contribution of 3 percent of compensation is too low for the plan to provide adequate retirement benefits.

While we support the direct transfer of pension fund assets to individual retirement accounts in cases where employers are unwilling to establish replacement plans, we believe that 401(k)s should be added to the list of plans authorized to receive pension fund distributions.

IRA accounts are too limited in contribution levels, and many of our members already participate in 401(k) plans as supplements to defined benefit plans.

Lastly, we are concerned that the bill does not provide any benefit protections for workers covered by plans with cash-out provisions for benefits less than $3,500. This lack of protection disproportionately affects low-wage workers in the service industries where high turnover and low pay would qualify them for the $3,500 cash-out provision.

The 150 hospital workers of the Service Employees Union, Local 767, are confronting this problem as we speak. These workers are employed at Tobey Hospital in Wareham, Massachusetts. The hospital is threatening to terminate the pension plan to recapture assets for business distress reasons. Those members who are vested will be cashed out under the $3,500 ERISA provision. Clearly, these workers would back the important protections contained in this bill but are missing for workers experiencing involuntary cash-outs.

Let me turn to some of the objections that may be raised in the Employee Pension Protection Act, objections which we regard as entirely without foundation.

Employers will question whether this legislation provides workers and retirees with unnecessary benefit protection. The proposed legislation correctly defines the pension promise as the actual benefit as defined in the plan and the amount of assets necessary to provide secure benefits in an ongoing plan.

In our view, if these basic standards cannot be met, employees should be adequately compensated. Pensions are not paid for and funded in a vacuum. Employees pay for them in trade-offs between increased wages or other benefits and pensions.

Employers also ask why employees should share in excess assets when they do not share in the risks of providing defined benefits. Workers share with employers in the actuarial gains and losses of pension fund assets. Actuarial losses are made up by workers over time, through either lowered wages or unimproved benefits. Workers are especially at risk for the reduction of benefits in termination situations.

Some have charged that the new bill would increase employer benefit liability. The bill, however, does not require any change in funding standards. It merely requires replacement plans to contain certain provisions for benefit security that are comparable to those that existed in the original plan before termination.

The threat of minimum funding as a result of such a bill has also been raised. Most employers do not establish pension plans to recapture excess assets. They do it to attract and retain employees. Employees expect that a promise of a pension plan will be fulfilled when they retire, which is why Congress grants employers a $50 billion tax break on pension contributions.

The AFL-CIO believes that the Employee Pension Protection Act reinstates the intent and purpose of pensions in this country which is to provide retirement security. It corrects a misguided public policy that has blatantly favored employers' business interests and disregarded workers' rightful share to their own pension fund monies.

Mr. Chairman, we are prepared to work with you and your staff to obtain an equitable and long-term legislative solution to this problem.

Thank you.

[The prepared statements of Mr. Bahr and the AFL-CIO Executive Council follow:]

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TESTIMONY OF MORTON BAHR, PRESIDENT, COMMUNICATION WORKERS OF AMERICA AND CHAIRMAN, AFL-CIO SUBCOMMITTEE ON PENSION TERMINATIONS AND REVERSIONS BEFORE THE SENATE LABOR COMMITTEE ON PENSION TERMINATIONS AND REVERSIONS

April 11, 1989

As Chairman of the AFL-CIO Subcommittee on Pension Terminations and Reversions, I am pleased to have this opportunity on behalf of the AFL-CIO to express our support for S. 685, the Employee Pension Protection Act. We commend you, Mr. Chairman, and your colleagues for your longstanding commitment to seek permanent legislation that protects the pension rights of workers and retirees covered by terminated plans. This issue is of utmost importance to many unions whose hard-earned pension fund assets constitute a major part of the $19.7 billion in employer reversions that have occurred since 1980.

Your initiative takes a major step towards stopping the wholesale looting by Wall Street raiders who cash out pension plans to finance corporate takeovers and by company executives who skim so-called "excess assets" when market values are high, leaving too thin a margin to meet pension obligations when values decline.

Your initiative addresses real problems that confront workers and retirees when plans are terminated and reversions are taken. Since several myths about this practice have been perpetuated, I would like to take this opportunity to address them before commenting on the legislation.

First, it is claimed that employers use pension fund assets in business deals that are designed to preserve workers' jobs or benefits. The fact is that use of pension fund assets in such deals frequently does great harm to workers. Since 1980, corporate mergers and acquisitions were responsible for the termination of 276 plans with $1.4 billion in assets reverting to employers for this purpose. In recent testimony before the House Ways and Means Committee, AFL-CIO President Lane Kirkland estimated that mergers, takeovers, and leveraged buyouts over the past decade cost 90,000 union members their jobs.

Second, it is not true that most workers whose plans have been terminated and are covered by replacement plans are provided the same level of benefits as the original pension. Since 1986, the number of workers covered by a defined benefit replacement plan has steadily dropped from 75% to 43% in 1988. And one-fourth of all participants in terminations received no new plan in 1988. Other benefit reductions result when annuities are purchased that are not indexed for inflation when workers and retirees forego benefit improvements, and when the fund is stripped of assets to protect it against market downturns. Study after study has shown that workers, not employers or the government, bear the brunt of plan reversions. Put simply, the Department of Labor estimates that participants lose an average of 45 cents for every pension dollar they would have received if the plan had not been terminated.

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We also support the one-time catchup for retirees whose pensions devalued by inflation have helped build the surplus in these "overfunded" plans. The Department of Labor found, that in 1986, only 35% of workers participated in pension plans that had granted a cost-of-living increase during the previous five years.

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Lastly, we are concerned that the bill does not provide any benefit protections for workers covered by plans with cash-out provisions for benefits less than $3,500. This lack of protection disproportionately affects low-wage workers in the service industries where high turnover and low pay would qualify them for the $3,500 cash-out provision. The 150 hospital workers of the Service Employees Union, Local 767 are confronting this problem as we speak. These workers are employed at Tobey Hospital in Wareham, Massachusetts. The hospital is threatening to terminate the pension plan to recapture assets for business distress reasons. Those members who are vested will be cashed out under the $3,500 ERISA provision. Clearly these workers would lack important protections contained in this bill but are missing for workers experiencing involuntary cash-outs.

Let me turn to some of the objections that may be raised objections in the Employee Pension Protection Act -- objections which we regard entirely without foundation.

Employers will question whether this legislation provides workers and retirees with unnecessary benefit protection. The proposed legislation correctly defines the pension promise as the actual benefit as defined in the plan and the amount of assets necessary to provide secure benefits in an on-going plan. In our view, if these basic standards cannot be met, employees should be adequately compensated. Pensions are not paid for and funded in a vacuum. Employees pay for them in trade-offs between increased wages or other benefits and pensions.

Employers also ask why employees should share in excess assets when they share in the risks of providing defined benefits. Workers share with employers in the acturial gains and losses of pension fund assets. Actuarial losses are made up by workers over time, through either lowered wages or unimproved benefits. Workers are especially at risk for the reduction of benefits in termination situations.

Some have charged that the new bill would increase employer benefit liability. The bill, however, does not require any change in funding standards. It merely requires replacement plans to contain certain provisions for benefit security that are comparable to those that existed in the original plan before termination.

The threat of minimum funding as a result of such a bill has also been raised. Most employers do not establish pension plans to recapture excess assets; they do it to attract and retain employees. Employees expect that a promise of a pension plan will be fulfilled when they retire, which is why Congress grants employers a $50 billion tax break on pension contributions.

The AFL-CIO believes that the Employee Pension Protection Act reinstates the intent and purpose of pensions in this country which is to provide retirement security. It corrects a misguided public policy that has blatantly favored employers' business interests and disregarded workers' rightful share to their own pension fund monies.

Mr. Chairman, we are prepared to work with you and your staff to obtain an equitable and long-term legislative solution to this problem.

Statement by the AFL-CIO Executive Council

on

Pension Plan Terminations and Reversions

February 24, 1989
Bal Harbour, Florida

Since 1980, the long-term economic security of nearly two million workers has been jeopardized by employers who have terminated single-employer pension plans and raided the plans for more than $19 billion of so-called excess assets.

Workers have a fundamental right to pension fund assets. Employers who terminate pension plans to skim off "excess assets" violate that right and deprive workers and retirees of their pension protection.

The $40 billion in annual tax breaks that employers receive for providing pensions is granted by Congress because pension plans are intended to be permanent.

In some cases, workers have been forced to take reduced pension benefits in the form of annuities that provide no protection against inflation. The Department of Labor estimates that participants who are put to that option lose an average of 45 cents for every dollar that they would have received if the plan had not been terminated.

Participants in terminated pension plans also may be forced to accept replacement plans with less generous benefits, and some workers may lose pension benefits altogether. Workers may find their pension funds misused by employers to finance corporate mergers and takeovers rather than invested in productive enterprises which would preserve workers' jobs and strengthen the economic base of local communities.

The AFL-CIO calls upon Congress to pass legislation that protects the pension rights of workers and retirees by placing sharp restrictions on the ability of employers unilaterally to appropriate pension funds. This legislation should include the following principles:

1. Where the employer claims that there will be so-called "excess assets" after a termination, workers and retirees should have the right to share in these assets with employers.

2. Such assets must first be allocated to satisfy the basic benefit security needs of workers and retirees before such assets are used for any other purpose. Benefit security should include assets necessary to fund benefits on an actuarially sound basis and assets necessary to shield plans from market downturns and inflation.

3. Once these basic benefit security needs are met, remaining assets should be allocated among employers, employees and retirees with financial incentives to encourage the continuation of defined benefit plans. When a pension plan is terminated, the percentage of excess assets made available to employers should bear a direct relationship to the type of replacement plan provided, with the largest amount allocated to employers who establish defined benefit replacement plans.

4. Collectively bargained pension plans should be permitted to allocate excess assets for some other agreed-upon purpose.

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Fact Sheet on AFL-CIO Proposal for Pension Terminations and Reversions

Fact Sheet

on

AFL-CIO Proposal on Pension Terminations and Reversions

I. Standards for Reversions

Employers who terminate pension plans would not have access to plan assets until they first satisfy the basic benefit security needs of plan participants and retirees. These basic benefit security needs include funds for: (1) a plan's projected benefit obligation (PBO) which includes accumulated pension obligations plus those benefits attributable to the effect of future salary increases on past service; and (2) a "cushion" or percentage of PBO to protect benefits against market downturns. Specific rules for determining comparable PBO amounts for non-pay related plans will be developed.

II. Allocation of Excess Assets

After basic benefit needs are met, excess assets should be shared among active workers, retirees and employers. In addition, employers should have financial incentives to provide defined benefit replacement plans.

The sharing approach has three components:

A. The floor or minimum level of benefits above which excess assets are available. The floor is the plan's projected benefit obligation which includes accumulated pension obligations plus benefits attributable to future salary increases, with an equivalent benefit liability amount calculated for non-pay related plans.

B. A cushion of some percentage of the PBO floor to protect against market downturns and to compensate participants/retirees for the likelihood of foregone benefit improvements, apart from those attributable to salary improvements.

C. A percentage allocation of remaining assets divided among active workers, retirees and employers.

We propose a sharing grid with financial incentives for employers to provide Defined Benefit replacement plans. The following chart is illustrative:

Type of Replacement Plan	Cushion	Reversion To Employer	Balance for Actives/Retirees
Defined Benefit Plan Replaced by Defined Benefit	x% of Benefit Floor	Highest %	Balance after Employer % Allocated
Defined Benefit Plan Replaced by Defined Contribution	x% of Benefit Floor		Balance after Employer % Allocated
Defined Benefit Plan Replaced by No Plan	x% of Benefit Floor	Lowest %	Balance after Employer % Allocated

III. Waiver for Collectively Bargained Plans

Labor and management involved in pension plans maintained pursuant to collective bargaining agreements could waive the sharing rules regarding allocation of assets among actives, retirees and employers to redirect the assets for some other agreed upon purpose, such as cash infusion into the company.

IV. Allocation of Assets Between Actives and Retirees

Excess assets should be shared between active workers and retirees. The allocation could be based on the present value of benefits, a dollar amount per year of service, or some other formulation. Specific rules for determining the allocation will be developed.

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Senator **Metzenbaum**. Thank you very much, Mr. Bahr.

I want to say publicly that I knew the red light was on, and I let you continue longer than that.

Mr. **Bahr**. I appreciate that, Senator.

Senator **Metzenbaum**. I did so because you are appearing here on behalf of the AFL-CIO, the major labor organization in this country speaking for employees. And therefore, when Panel 5 comes before us, I will say that industry representatives will also be given the same amount of extra time as you were given, so that nobody can say that we are not trying to be balanced in this hearing.

Mr. Bahr, how many union pension plans, if you know, are overfunded?

Ms. **Miller**. I think that the Department of Labor statistics show that the majority of pension plans are overfunded. Many union folks—and I would say the majority of them—are in both multi-employer and defined benefit plans that are overfunded right now.

We know that at least 80 percent are overfunded on a termination liability basis, and the Department of Labor statistics also show that 50 percent are overfunded beyond 150 percent.

So we can be reasonably sure that the majority of our folks are in those kinds of plans.

Mr. **Bahr**. I can tell you in the telephone industry they are all overfunded.

Senator **Metzenbaum**. Well, is it not the fact that they are overfunded not because of the employers' excess contributions, but because the stock market rose far beyond what anybody anticipated it would rise, and interest rates have gone up so much higher than when many of these funds were originally set up; is that not the major reason?

Mr. **Bahr**. That is largely the reason, yes.

Senator **Metzenbaum**. How much of a threat do you feel that reversions represent to the workers you represent—I mean not only CWA employees, but members of the AFL-CIO generally and workers generally?

Mr. **Bahr**. Well, I think when we look at the fact that 400 plans are now waiting to be approved if this legislation is not adopted, that that indicates the scope of the problem. There are already 400 applications waiting to be approved.

Senator **Metzenbaum**. I want to say, Mr. Bahr, that I also started off this hearing with my understanding that there were 400; I have since been informed that there are actually 600 that are waiting to be approved. This compounds the problem, it does not make it less of one.

Mr. **Bahr**. That is correct.

Senator **Metzenbaum**. How difficult do you feel it has been for unions to prevent companies from terminating overfunded pension plans?

Mr. **Bahr**. Well, it does not seem to have been difficult at all by virtue of the fact that they have been taking place. We are, for example, at a disadvantage as well in that bargaining for those already retired is permissive and not mandatory. And it is difficult to bargain on a termination of a plan when those who are already retired, the employer does not have to bargain with you. It is going into the ring with one hand tied beyond your back.

And of course, there are so many unorganized; you know, 85 percent of the private sector is unorganized, and those workers are entitled to protection as well.

Senator METZENBAUM. AT&T as well as each of the "baby Bells" have substantial overfunded pension plans?

Mr. BAHR. Yes. They are all between 140 and 150 percent overfunded. But even there, it is quite interesting to note that in 1980, when as a result of a quid pro quo at the collective bargaining table, such as the union agreeing to move away from a wage-related pension plan to a set pension plan, in return, the company agreed to bargain for those already retired, and that was great, until the first negotiations after divestiture, which was in 1986, when three of the spun-off companies then refused. And of course, they were not required by any agreement to have done that.

So we are moving back in the opposite direction. I would also point out, after listening to the earlier testimony, I originally came out of IT&T many years ago, and my former local union president, who retired in 1968 at a pension of a little over $200 a month, today is still receiving precisely the same pension from one of the major companies in this country.

Senator METZENBAUM. That is incredible. He retired in 1968?

Mr. BAHR. In 1968.

Senator METZENBAUM. That is incredible.

Mr. BAHR. And the reason I am aware of this is that I just received, a week or two ago, a very pitiful letter that his wife had passed away, and that by losing her half of the Social Security, he almost can't make it. This happens countless times around this country to those who put in so many years of service.

Senator METZENBAUM. I will tell you an interesting fact that occurred to me as this hearing was proceeding. In the past we have had legislation along the same lines, and it appeared at one point that we were going to be able to move it pretty rapidly. I will never forget when the top executive and one of the major principals in one of America's best-known companies—one who was involved in having taken out hundreds of millions of dollars—I remember he came and asked to have lunch with me, so I had lunch with him. At that time he indicated his concern about their right to terminate. And I said to him, "Well, I would have less concern about your right to terminate provided that you left in enough to provide cost-of-living increases—adjustments in the pension."

And I remember he said, "That's no problem. Just work it out with our people. That is fine with me. I am satisfied with that."

That did not occur; the law did not pass. The bottom line was the company took out all of the funds, and the employees of that company received no adjustments.

It is my view that employers will come here and oppose this legislation, but that individual employers, if asked, would say, "We are willing to provide for cost-of-living adjustments. We would expect it in our own pensions; we would expect to be treated in that manner." After all, the people who are making the decisions at the executive level are also employees of the corporation, and when they receive their pensions, they expect cost-of-living adjustments. For them to terminate pension plans without providing cost-of-living adjustments reflects the sort of community that together says, "No, no, no, no, no." But individually, if you sat down with the heads of various corporations, I think there is enough compassion and reasonableness in them that they would say, "Fine—provide for cost-of-living adjustments, but let us take out the excess." And I am frank to say that is pretty much what our legislation does.

Mr. **Bahr**. I would concur with that. What we seek here is only equity. We are suggesting that those who have a stake—and that is the employer, the future retirees and those who are already retired—each has equity. And we are suggesting in this legislation that that equity be distributed fairly.

You know, when you bargain a contract, there is only one economic pie to be shared, and whatever the costs are, they are allocated to wages and fringe benefits. There is absolutely no doubt that historically, if you were not going to allocate money to a pension plan, it would have gone somewhere else. Workers would have enjoyed higher wages or other benefits.

So it is not myth that this indeed is deferred wages we are talking about. And notwithstanding that, we are not saying that all of it belongs to the workers or to the retirees. And just as a matter of fairness, we should be able to win some of the more progressive employers over support of this bill.

Senator **Metzenbaum**. I think that too many people forget that what the employer puts into the pension fund is part of the allocation for labor costs. In that sense, labor could be arguing that all of the excess belongs to them. If you had put aside for labor, or given to them the 42½ cents an hour, or whatever the amount may have been, they could have established their own pension fund. They could have made investments, and then they would have been getting all the advantages of interest increases and stock increases.

Mr. **Bahr**. As an example, Senator, AT&T has not put a nickel into the pension plan since 1986, yet it is well overfunded. I think it makes the point that you made earlier.

Senator **Metzenbaum**. I am very happy to see Senator Jeffords has joined us.

Senator, if you have an opening statement or any questions, we would be very happy to have you participate and are pleased that you are here.

Senator **Jeffords**. Thank you very much, Senator.

First of all, this is an issue I am very interested in. Unfortunately, I have had a physical exam scheduled for some length of time, and I wanted to make sure I was going to be around for a while, so I did that and was not able to be here earlier.

I do not have any questions at this particular time, but I will be reviewing the testimony which has been delivered here this morning and giving it my best judgment. These are very serious and important questions which we are dealing with, and I appreciate the testimony of the witnesses this morning.

Senator **Metzenbaum**. Thank you very much.

Thank you very much, Mr. Bahr.

Mr. **Bahr**. Thank you, Mr. Chairman.

Senator **METZENBAUM**. Our next panel is Jack Guildroy, member of the Board of Directors, American Association of Retired Persons, Washington, D.C.; and Karen Ferguson, Executive Director, Pension Rights Center, Washington, D.C.

And although I made allowances for the previous speaker, I do want to say that the five-minute rule will be reinstated up until the time we get to Panel 5.

Mr. Guildroy, we are very happy to hear from you, sir.

STATEMENTS OF JACK GUILDROY, MEMBER, BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON, DC, ACCOMPANIED BY DAVID CERTNER, AARP LEGISLATIVE STAFF; AND KAREN FERGUSON, EXECUTIVE DIRECTOR, PENSION RIGHTS CENTER, WASHINGTON, DC, ACCOMPANIED BY KAREN FRIEDMAN, EDUCATION DIRECTOR

Mr. **GUILDROY**. Thank you, Senator.

My name is Jack Guildroy, a member of the Board of Directors of AARP. With me is David Certner of our legislative staff.

I am pleased to testify on behalf of AARP in support of S.685, the Employee Pension Protection Act of 1989.

We commend both of you for your continued leadership on this important pension reform issue. AARP agrees that terminations for reversions are harmful to the long-term security of plan participants and contrary to the basic thrust of our pension and tax laws.

We believe this bill will discourage pension sponsors from prematurely terminating well-funded plans in order to gain access to pension money.

Under current law, the employer is required to pre-fund defined benefit plans in order to meet projected benefit obligations. This prefunding, coupled with higher than expected rates of return, has led to large build-ups in pension assets. These assets, generally needed to meet the long-term retirement security of workers and retirees, are now viewed as a pot of gold by some employers.

Since 1980, about 2,000 companies have raided their pension plan, recapturing nearly $20 billion of plan assets. About 2 million plan participants have been affected.

In a termination, active employees lose out on the best years of their pension promise, often leading to substantial pension losses. In particular, older workers who have already invested much time in the company may be harmed.

For retirees, the removal of plan assets means that the opportunity for any adjustments to their frozen pension amounts effectively disappears.

Also, all participants in the Federal Government take the risk of stripping pension plans of their needed cushion of funds. The importance of such a cushion was dramatized by the recent stock market crash in which pension funds lost about 20 percent of their value overnight. Recaptured money has also fueled the takeover activity on Wall Street. The need for short-term cash flow both to fight off takeovers and to engage in takeovers has often led directly to the pension pot of gold.

Of the 200 largest reversions since 1985, about 40 percent of the companies were also involved in mergers and acquisitions, and leveraged buyouts accounted for about 40 percent of this activity.

AARP believes legislation to ensure retirement benefit security is long overdue. We believe S.685 addresses the issue of terminations for reversions in a comprehensive and thoughtful manner, balancing the needs of the pension system, plan participants, and plan sponsors. Enacting S.685 should therefore be a top priority.

We strongly support this bill, which would redefine so-called "pension excess" to more accurately reflect funding obligations. It would encourage the establishment of replacement plans, including adequate cushion amounts. It would require a sharing of reversion assets with employees and retirees.

Those who defend the status quo that allows the return of tax-preferred assets to the employer, undermine the basic thrust of our pension laws. The large tax subsidy for pension plans should lead to long-term retirement security, not back to the employer's pocket.

The current short-sighted view of pension assets not only threatens future benefit security; it also undermines faith in the entire pension system.

AARP believes restrictions on terminations for reversions are thus essential; that the Employee Pension Protection Act of 1989 should discourage terminations for reversions and better encourage long-term retirement security. AARP therefore stands ready to help this committee and this Congress to enact this much-needed legislation.

Thank you very much.

Senator METZENBAUM. Thank you, Mr. Guildroy.

[The prepared statement of Mr. Guildroy follows:]

AARP

STATEMENT

OF THE

AMERICAN ASSOCIATION OF RETIRED PERSONS

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

ON

S. 685

"THE EMPLOYEE PENSION PROTECTION ACT OF 1989"

APRIL 11, 1989

American Association of Retired Persons 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700

Louise D. Crooks *President* Horace B. Deets *Executive Director*

The American Association of Retired Persons appreciates the opportunity to testify today in support of proposed changes to the current treatment of pension plan terminations for reversions. AARP believes that S. 685, the "Employee Pension Protection Act of 1989," will halt the current trend of pension plan sponsors prematurely terminating well-funded pension plans merely to gain access to pension money. In addition, this bill should further the general purposes of pension law to provide for long-term retirement security.

In general, this bill accomplishes several necessary objectives:

* Discourages employers from terminating healthy pension plans solely to recapture plan assets,
* Encourages replacement plans to better protect workers' retirement benefits,
* Requires that replacement plans retain a "cushion" of assets to guard against investment downturns,
* Requires that workers and retirees "share" in a portion of the assets of the pension trust that was established and maintained on their behalf.

I. Overview of Problem

The money building-up in pension funds for future retirement security -- in defined-benefit plans in particular -- has been exploited in recent years as a ready source of cash for non-retirement purposes. Under current law, a company cannot withdraw assets from an ongoing pension fund. However, the law allows a company to completely terminate a pension plan, pay benefits that were earned up to the date of plan termination, and recapture any assets that remain in the pension trust. There are no restrictions on the employer's use of these assets (although a 15 percent excise tax applies).

In general, defined-benefit plans are plans that promise a specific pension benefit upon retirement. The benefit amount is usually based on a formula involving number of years of service and salary. Because of this formulation, these plans tend to accrue benefits more rapidly in the later years of an individual's work life, when both salary and number of years on the job is highest. In order to account properly for the build-up in pension benefits in the later years, companies generally are required to prefund their pension benefits in the early years.

This prefunding, coupled with better than expected returns on investment of plan funds, has led to a large build-up in pension funds beyond what is currently needed to satisfy the accrued benefits of plan participants. A recent study of Fortune 500 companies (using 1987 financial statements) indicated that 86 percent of companies had assets in excess of their accrued pension benefit obligations. While these funds will for the most part be needed in ongoing plans to meet future benefit obligations, they are considered "excess" on a current plan termination basis (i.e., benefits currently owed if a plan is terminated today). In total, it has been estimated that the current amount of pension fund "excess" on a plan termination basis is about $200 billion.

While originally intended for long-term retirement security, the build-up of assets in defined benefit plans has become a corporate "pot of gold." Employers have sought access to pension assets for any number of reasons, such as improving the outlook on the balance sheet or financing corporate takeovers. This diversion of retirement funds from their intended purpose frustrates the goals of the private pension system and threatens the retirement security of millions of individuals.

II. Scope of Problem of Terminations for Reversions

The scope of pension terminations for reversions in this decade is alarming. Terminations for reversions were essentially unknown before 1980. Since that time, through 1988, (according to the most recent Pension Benefit Guarantee Corporation (PBGC) information), nearly two thousand plan terminations with reversions of over $1 million have been completed. The total amount of recaptured pension assets has now reached nearly $20 billion, and the number of plan participants affected by these terminations is over 2 million.

Attempts to discourage and/or restrict asset reversions have been on the legislative agenda for the past several years. While most agree that terminations for reversions are a problem that must be resolved legislatively, an acceptable solution has yet to be enacted.

III. Harm to Plan Participants

Generally, whether an employer establishes a new pension plan (and what type of plan) determines the extent employees are harmed. Again, PBGC data on pending pension terminations as of September 30, 1988, is instructive. According to the PBGC, one-quarter of plan participants are in terminating plans for which no new plan is established. In addition, one-half of terminated plan participants are transferred to defined-contribution plans, in which investment risk falls on the employee. Only one quarter of participants are continued in plans in which the employee is generally best protected -- a reestablished defined benefit plan. Even in these instances, the plan is bound to be far less well funded, since the "cushion" of assets that had been built up has now been stripped by the termination.

To demonstrate the effect a plan termination may have on an employee, it is instructive to look at an example of an older worker in a typical defined benefit plan that is terminated. If no replacement plan is established for a hypothetical 55 year old worker (with 30 years of service) who intends to work to age 65, the reduction in benefits can be over 50 percent (Brandeis University study on "The Impact of 'Overfunded' Pension Terminations on Workers"). Even if a defined contribution-type plan is established, it is practically impossible for an older worker to make up for these losses.

Company retirees may also be hurt in a plan termination. In a termination, annuities are generally bought to cover retirees' benefits. The practical result is that retirees are unlikely to receive any future pension adjustments. This contrasts with the latest Department of Labor information that suggests that nearly 40 percent of retirees in continuing pension plans have received some type of ad hoc pension adjustment to compensate for the loss of value in pension amounts over time.

IV. Description -- The "Employee Pension Protection Act of 1989"

AARP strongly supports S. 685, the "Employee Pension Protection Act of 1989" (EPPA) and believes that enactment of such benefit protection legislation is long overdue. This bill addresses the issue of terminations for reversions in a comprehensive and thoughtful manner, attempting to balance the needs of the pension system, plan participants, and plan sponsors.

EPPA effectively discourages employers from terminating their pension plans solely to recapture plan assets by clarifying the fiduciary standards in Title I of the Employee Retirement Income Security Act (ERISA) to ensure that employers who do terminate their plans adequately protect the benefits of plan participants.

Under the bill, as under current law, an employer that terminates a pension plan must vest all benefits earned up to the date of termination. In addition, before an employer can take a reversion of assets, certain additional requirements must be met. The allowable reversion amount will depend on the establishment of a new plan, and will thus fall into three categories, described as follows: (1) a complete replacement plan, (2) a substantial replacement plan, or (3) no replacement plan.

1. Complete Replacement Plan

A complete replacement plan is defined as one in which the newly adopted defined-benefit plan contains assets of 125 percent of the projected current liability under the terminated plan. Also, all employees must be kept whole by providing them with equivalent benefits (in amount and form) as before the termination, including at least as great a benefit accrual rate and past service credits.

In addition to the "cushion" amount required for active employees, a one-time benefit adjustment for retirees (and terminated vested participants) must be made from plan assets. This one-time benefit adjustment is based on increases in the

Consumer Price Index (CPI), less benefit adjustments already made by the plan to these participants. Funds remaining after satisfying these benefit protections may then revert to the employer.

2. Substantial Replacement Plan

A substantial replacement plan is defined as one in which the newly adopted plan (or individual accounts) contains assets of 135 percent of the projected current liability under the terminated plan. For new defined-benefit plans, employees must again be kept whole in the retention of service credits and benefit rights. In order to be considered a "substantial" replacement plan, any newly adopted defined-benefit or defined-contribution plan (or plans) must meet certain minimum benefit levels. As above, a one-time benefit adjustment to retirees (and terminated vested participants) must also be made. Again, any amounts remaining after satisfying these new requirements may then revert to the employer.

3. No Replacement Plan

In the event no replacement plan is adopted, plan assets shall be distributed by direct transfers to individual retirement accounts or annuities as follows. First, employees will receive 135 percent of the projected current liability of the terminated plan. Second, retirees (and terminated vested participants) will receive a one-time benefit adjustment based on increases in the CPI. Third, any remaining assets shall be distributed to employees on a pro-rata basis. If no replacement plan is established, or a plan does not meet the minimum requirements to qualify as a replacement plan, then the employer may not take any reversion of pension assets.

V. Analysis -- "The Employee Pension Protection Act of 1989"

In general, the bill would make two major changes to the current law treatment of pension terminations for reversions. First, the bill would recognize "projected current liability" as the standard by which to measure plan "overfunding" -- a standard more consistent with current long-term ~~pension~~ funding principles. This redefinition is essential to a more rational view of plan "overfunding." Second, the bill would require "cushion" amounts and/or asset allocation dependent on the type of replacement plan, if any, established by the employer. These provisions are essential to ensure future retirement security. Both of these changes recognize the need to treat retirement benefit security on a long-term basis.

1. Projected Current Liability

Under current law, when a plan terminates, any amounts above termination liability are considered "excess". Termination liability is effectively defined as the amount owed to plan participants at the date of termination. This determination of "excess" ignores the fact that defined-benefit plans are funded as ongoing plans with ongoing liabilities. Because this type of plan accrues benefits more rapidly in the later years, the plan is pre-funded (under ERISA's required minimum funding standards) in the early years in order to meet the ongoing projected liability.

Projected liability takes into account future inflation and salary increases in order to properly recognize ongoing plan funding needs. In fact, while plans may be considered to have "excess" assets on a plan termination basis, there may be no "excess" assets on an ongoing plan basis. In other words, it is the act of termination itself that causes "overfunding" simply because future benefit years are eliminated.

While plans have been required to meet minimum funding standards in order to meet ongoing benefit obligations, current law does not recognize that obligation in a termination. This failure to recognize the ongoing obligation in a defined-benefit plan termination undermines the value of these plans for employees. In addition, terminating healthy defined-benefit plans merely to gain access to plan money frustrates the tax-subsidized goal of pre-funding these plans in order to encourage adequate retirement income security.

EPPA correctly recognizes the inconsistency in current law which requires funding on an ongoing basis and liability on a termination basis. This bill rectifies this problem by requiring that projected current liability be the standard for determining "overfunding" at termination. Projected current liability -- which takes into account future salary increases -- reflects the actuarial standard used to fund the plan on an ongoing long-term basis. As such, this standard describes more accurately the extent to which a plan may have "excess" assets.

2. Cushion Amounts/Asset Allocation

While projected current liability more accurately reflects plan liability, this standard alone does not provide sufficient protection in an ongoing plan. In addition to what is needed to pay promised future benefits, the pension plan must also take into account future investment downturns and benefit adjustments that may affect plan assets. For example, the stock market crash of 1987 illustrated what could happen to pension assets in the event of an economic downturn. Estimates are that pension plans lost 20 percent of their value overnight in the crash. AARP believes that "cushion" amounts are essential to ensure future pension benefit security.

To avoid potential future harm to plan participants and the pension system in general, EPPA requires replacement plans to contain asset "cushions" at levels above projected current liability. In order to encourage the employer to maintain the retirement security of plan participants, the size of the cushion -- and thus the corresponding reversion amount -- is determined by the type of newly established plan.

A "cushion" of 125 percent of projected current liability is required for establishing an identical defined-benefit plan. For the establishment of a less generous defined-benefit plan, or a defined contribution plan, a higher cushion of 135 percent of projected current liability is required. This differential will encourage employers to reestablish an identical defined benefit plan, providing workers with the most complete coverage. Older workers and long-term workers have the most to lose when a defined-benefit plan is terminated. AARP believes the higher "cushion" required for substantial replacement plans recognizes the loss of value to plan participants in shifting to a less generous plan.

If the employer does not establish a new plan, or establishes only a sham plan, the employer will not receive any asset reversion. By transferring pension assets to IRA's or other retirement vehicles, AARP believes the assets in the plan will be used for their proper purpose -- that of providing retirement security to plan participants. By prohibiting asset reversions in these circumstances, the bill will also encourage employers to set up replacement plans, thus improving the retirement security of employees.

In addition, in any termination, the employer is required to give a one-time benefit adjustment to retirees. Generally, in a termination, annuities are purchased for retirees, effectively freezing them at current benefit levels. The one-time benefit adjustment will require employers to increase the value of these annuities by an amount based on the CPI, less any increases already given by the plan. This increase will help restore the lost purchasing power of the pension benefit for retirees -- a value that has been substantially eroded by inflation. For the more responsible companies that have already given past increases, a set-off will be permitted. Prior beneficial actions will therefore not be penalized, and future ad hoc adjustments will not be discouraged.

The one-time increase also recognizes the fact that retirees, in a termination, will effectively be foreclosed from future benefit adjustments, since they will no longer be part of any pension plan. Current pension practice indicates that a large percentage of retirees have received benefit adjustments in retirement -- recent Department of Labor figures estimate the percentage of retirees receiving benefit adjustments at about 40 percent. By requiring that a portion of assets in the plan be used to provide a one-time increase to retirees, AARP believes that pension assets will again be used for a purpose for which they were originally intended -- providing adequate retirement security.

VI. Correlation of Leveraged Buy-Outs to Pension Reversions

The recent wave of corporate takeovers has recently received much Congressional and public attention. The Association believes that pension plan assets have played a significant role in this activity. To the extent that the financial markets and corporate managers are preoccupied with cash flow, pension assets will remain a target and a source of cash that help fuel takeovers, as illustrated in the following ways: Company A may take over Company B, then terminate Company B's pension plan, removing any pension funds not needed to pay plan benefits earned up to that date. These recaptured funds may then be used to help pay off corporate debt originating from the original takeover. On the other hand, Company B, realizing it is the target of a takeover, may prematurely terminate its own plan in order to gain access to cash to help it fend off a takeover bid. Company B's termination of its own plan may also make it a less attractive takeover target.

To underscore the role that pension assets have played in takeovers, it is instructive to review PBGC lists of companies that have completed terminations for reversions, and compare them with companies that have been involved in merger and acquisition activity. While it is difficult to trace the exact use of money recaptured from pension funds, the cross-match of companies highlights the current threat to participant's pension security.

A strong correlation exists between companies with terminations for reversions and those involved in mergers and acquisitions, particularly where large pension reversions are involved. Analysis of the available information for the approximately 200 companies with the largest pension reversions (over $10 million recaptured by the employer) between January 1, 1985 and September 30, 1988, indicates that at least 40 percent had also been involved in merger and acquisition activity. Of this activity, over 40% were leveraged buy-outs. The total amount of pension reversions in this time period for these companies is approximately $8.4 billion. No doubt a portion of these recaptured pension funds played a significant role in non-pension related actions.

VII. Proponents of the Status Quo

There are many who believe that the interpretation of current law which allows a company to gain access to plan funds in a plan termination should not be changed. AARP believes this view is inconsistent with the basic intent of our pension and tax laws.

Opponents of restrictions on plan reversions contend that the inability to recapture plan funds will cause employers to underfund their pension plans. AARP believes such a view was not held by employers in the pre-1980 period, when access to plan funds was essentially unknown. Employers at that time (as should be the case now) funded their plans consistent with actuarial determinations of funding needs in an ongoing pension plan.

Funding reforms enacted in 1987, which generally increased the levels of funding necessary in defined-benefit plans, should further prevent employers from intentionally underfunding their plans. In addition, plans should not be encouraged to build-up plan assets on a tax-preferred basis merely to have them revert to the employer later.

Employers also argue that in a defined-benefit type plan, which guarantees a specific benefit upon retirement, the employer takes all the risk, and therefore should be able to reap all the gain. AARP believes this argument is misplaced in several basic respects. First, employers do not take all the risk. The tax code provides significant tax benefits for pension plans, allowing both deductions for contributions to plans and the tax-free build-up of pension fund assets. The reason for this tax advantage is to better provide for retirement security. Therefore the federal government, and all taxpayers, have a substantial stake in the growth in pension funds. Second, in the event of an economic downturn, the PBGC will step in to insure that pension participants receive at least some of their guaranteed pension benefits. Thus, the pension "risk" is spread beyond each individual employer.

Even more basic is the concept that there is any "gain" at all. Using "current plan termination basis" for calculating pension "surplus" is, in our view, misleading. In an ongoing pension plan, there generally are few, if any, "surplus" pension assets. Assets accumulating in the plan are intended -- and actuarially determined -- for future retirement benefits. Large "surplus" assets are created by the act of plan termination itself. This short-sighted characterization of pension assets in a plan termination is at odds with the basic intent of ERISA and the tax laws to provide for long-term retirement security.

In fact, the law already provides the employer with a "gain" from better than anticipated returns on investment -- the ability to reduce contributions in later years. This gain, determined actuarially year-by-year in an ongoing pension plan, is one that provides for long-term stability. Long-term accountability such as this is more consistent with the basic thrust of ERISA and the tax laws.

VIII. Conclusion

In conclusion, the Association believes the recent wave of terminations for reversions has had a detrimental impact on benefit security. This activity has been exacerbated in the context of corporate takeovers. Already, over $20 billion has been removed from pension plans and diverted for non-retirement purposes, frustrating the basic intent of ERISA and the Congress to foster retirement security.

Congress has examined this issue for years, and it is now time to act. AARP believes that S. 685, the Employee Pension Protection Act, will discourage terminations for reversions and better encourage long-term retirement security. The Association applauds the chairman of this subcommittee for his leadership on this pension security issue, and AARP looks forward to working with this subcommittee, and this Congress, to swiftly enact this much-needed pension reform legislation.

Senator **Metzenbaum**. Let me ask you this. Some people claim that changing the law will harm pension plan funding. What are your thoughts on that subject?

Mr. **Guildroy**. I understand what the argument is. I do not really believe in its viability. Before 1980, we had no problems at all with reversions. It is only since 1980 that some of these new, creative ideas have come forward.

Pension plans are set up not only to benefit workers; they are definitely set up to help employers. Employers not only get tax benefits, they not only get benefits on their contributions to the pension funds, and indeed, they pay no taxes on the income from the investments in the pension funds—they also attract good workers, who they need. They also are able to keep good workers that they need.

Senator **Metzenbaum**. Is this a subject, pension terminations, that is discussed often, or is very much part of the AARP agenda?

Mr. **Guildroy**. It is definitely one of our top priorities, Senator. It has been and it remains so.

Senator **Metzenbaum**. Thank you very much.

Mr. **Guildroy**. Thank you.

Senator **Metzenbaum**. Karen Ferguson, Executive Director of the Pension Rights Center in Washington, we are happy to have you with us.

Ms. **Ferguson**. Thank you, Senator Metzenbaum, Senator Jeffords.

I am Karen Ferguson, Director of the Pension Rights Center, and with me is Karen Friedman, the Education Director of the Center. We are very pleased to be here today to testify in support of the Employee Pension Protection Act.

The Employee Pension Protection Act represents a rational, workable and realistic compromise solution to the difficult problem of pension plan raiding. It recognizes the legitimate concerns both of plan sponsors and of plan participants. It would encourage companies to continue to maintain soundly funded defined benefit plans, while at the same time curbing a practice that has decimated the pension expectations of hundreds of thousands of workers and retirees.

The bill takes the common sense approach of looking at how much of the money now being taken out of plans is truly "surplus" or "extra" money, and how much of that money is not really surplus at all. The bill allows employers access to true surplus, but not to other plan assets.

The bill recognizes that a good part of what, up until now, has been called surplus money is money that is in plans because most defined benefit plans fund the benefits promised to active workers on an "ongoing" basis, and because these plans ordinarily do not adjust retirees' benefits automatically for increases in the cost of living. The bill clarifies that the money in plans that is attributable to these two factors is not extra, or "surplus", plan money.

The bill's starting point is that defined benefit plans are typically funded on an ongoing basis. This means that enough money is put into the plan to take account of the fact that the years participants have worked as of any particular date will be worth significantly more if the participants continue to work under the plan until a later date.

The money put into a plan to assure that the full value of participants' "projected" benefits will be paid is not "extra" money. Yet under current rules, companies are permitted to take this money out of plans and use it for corporate purposes. The result is either that plans become seriously underfunded, or that workers are left with a fraction of the benefits they had counted on getting.

Under the Employee Pension Protection Act, money that is needed for ongoing funding of projected benefits would not be considered to be surplus money and would remain as a part of a funding "cushion" in the plan.

The bill also recognizes that prudent funding requires a buffer against declines in the stock market. There is presently no requirement that a "contingency margin" be retained in a plan. A plan can now be stripped down to its bare bones, even if this would put plan benefits at risk. The Employee Pension Protection Act would assure that funding needed to protect against stock market downturns would be part of a plan's asset cushion. It would not be considered to be "extra" money that could be taken out of a plan.

The bill's approach of redefining "surplus" would provide important protections to retirees as well as to active workers. The legislation acknowledges that some of the money now being siphoned out of pension plans is in the plans solely because they are paying retirees in inflation-eroded dollars. That money is not "surplus" or extra money. It is a windfall to plans resulting from the fact that private pension plans, unlike Federal and other Government plans, are not automatically adjusted for increases in the cost of living.

Under current law, if a plan earns a return on investments in 1989 dollars and pays retirees benefits in devalued dollars, the "surplus" created can be "recaptured" by the company. This effectively creates a redistribution of income from the retirees to the company.

The Employee Pension Protection Act takes account of the devastating impact that the erosion of the real value of their pensions can have on retirees by providing a one-time retroactive catch-up adjustment to restore the purchasing power of their pensions.

The bill recognizes that the oldest retirees are affected the most dramatically by inflation. An individual who retired in 1972 with a pension of $100 a month now has a benefit worth less than $37 a month. Even at a low 4 percent inflation rate, the value of a fixed pension benefit will be cut in half over a pensioner's retirement years.

The Employee Pension Protection Act redefines what is and is not surplus money in a very practical way. A company can continue a defined benefit plan and have access to "extra" money as long as that money is not needed to provide an asset cushion to protect the value of the benefits of active workers and as long as that money is not needed to restore the purchasing power of retirees' pensions.

Approaching this issue in this way seems to us to be conceptually sound. It avoids the unresolvable question of who "owns" the pension money, and does not result in arbitrary splitting of assets that can result in seriously underfunded plans and in "gifts" to both employers and employees.

The bill also effectively responds to the pension industry criticisms of previous proposals, namely, that they would have encouraged underfunding of defined benefit plans, or even their termination. This bill provides strong incentives aimed at encouraging employers to continue to maintain well-funded defined benefit plans.

The legislation will, of course, not stop pension plan raids. A great many companies will still be able to take money out of plans. The only situations where companies continuing defined benefit plans will not be able to take out money is where there is in fact no "surplus" money in the plan.

Many of the grassroots activists we have been working with around the country would have liked to see this legislation go further. They had hoped Congress would put an end to all raids on plans. They feel strongly that any "extra" money in plans should be used for much-needed improvements in their benefits.

Although we would also prefer a total ban on reversions, it has now been five years since this subcommittee's first hearing on the subject, and billions of dollars have been taken out of pension plans. It is time for a solution to this problem. We think that the Employee Pension Protection Act represents a solid, well-thought-out approach, and we applaud you, Mr. Chairman, for taking the initiative and introducing this important, innovative legislation.

Thank you.

[The prepared statement of Ms. Ferguson follows:]

STATEMENT OF THE PENSION RIGHTS CENTER
BEFORE THE
SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
U.S. SENATE
WASHINGTON, D.C.
APRIL 11, 1989

Mr. Chairman, members of the Subcommittee, I am Karen Ferguson, Director of the Pension Rights Center. Accompanying me is Karen Friedman, the Center's Education Director. The Pension Rights Center is a public interest group that has been working for the past thirteen years to protect and promote the pension interests of workers, retirees and their families. We thank you for the opportunity to testify in support of S. 685, the Employee Pension Protection Act of 1989.

The Employee Pension Protection Act represents a rational, workable and realistic compromise solution to the difficult problem of pension plan raiding. It recognizes the legitimate concerns both of plan sponsors and of plan participants. It would encourage companies to continue to maintain soundly funded defined benefit plans, while at the same time curbing a practice that has decimated the pension expectations of hundreds of thousands of workers and retirees.

The bill takes the common sense of approach of looking at how much of the money now being taken out of plans is truly "surplus" -- or "extra" -- money, and how much of that money is not really surplus at all. The bill allows employers access to true plan "surplus," but not to other plan assets.

The bill recognizes that a good part of what up until now has been called surplus money is money that is in plans because most defined benefit plans fund the benefits promised to active workers on an "ongoing" basis, and because these plans ordinarily do not adjust retirees' benefits automatically for increases in the cost of living. The bill clarifies that the money in plans that is attributable to these two factors is not extra, or "surplus," plan money.

The bill's starting point is that defined benefit plans are typically funded on an ongoing basis. This means that enough money is put into to the plan to take into account the fact that the years participants have worked as of any particular date will be worth significantly more if the participants continue to work under the plan until a later date when, for example, their earnings are higher or they are closer to retirement age.

The money put into a plan to assure that the full value of participants' "projected" benefits will be paid is not "extra" money. Yet under current rules, companies are permitted to take this money out of plans and use it for corporate purposes completely unrelated to retirement security. The result is either that plans become seriously underfunded or that workers are left with a fraction of the benefits they had counted on getting. Under the Employee Pension Protection Act money that is needed for ongoing funding of projected benefits would not be considered to be surplus money and would remain as part of a funding "cushion" in the plan.

The bill also recognizes that prudent plan funding requires a buffer against declines in the stock market. There is presently no requirement that a "contingency margin" be retained in a plan. A plan can now be stripped down to its bare bones, even if this would put plan benefits at risk. The Employee Pension Protection Act would assure that funding needed to protect against stock market downturns would be part of a plan's "asset cushion." It would not be considered to be "extra" money that could be taken out of a plan.

The bill's approach of redefining "surplus" would provide important protections to retirees as well as to active workers. The legislation acknowledges that some of the money now being siphoned out of pension plans is in the plans solely because they are paying retirees in inflation-eroded dollars. That money is not "surplus" or extra money. It is a windfall to plans resulting from the fact that private pension plans, unlike federal and many other government plans, are not automatically adjusted for increases in the cost of living.

Under current law if a plan earns a return on investments in 1989 dollars, and pays retirees benefits in devalued dollars fixed as of the dates the retirees stopped working, the "surplus" created can be "recaptured" by the company. This effectively creates a redistribution of income from the retirees to the company.

The Employee Pension Protection Act takes account of the devastating impact the erosion of the real value of their pensions can have on retirees by providing a 1-time retroactive catch-up adjustment to restore the purchasing power of their pension. The bill recognizes that the oldest retirees are affected the most dramatically. An individual who retired in 1972 with a pension of $100 a month now has a benefit worth less than $37 a month. Even at a low 4% inflation rate the value of a fixed pension benefit will be cut in half over a pensioner's retirement years.

The bill is consistent with the practice of most larger plans before they are raided. Companies with surplus assets commonly adjust retirees' benefits to take account of increases in the cost of living. Pacific Lumber Company in Scotia, California is just one example. Bill Hunsaker, who had managed the pension fund for the last 20 of his 40 years with the company told us that the plan intentionally used conservative actuarial assumptions in order to build up plan "surpluses" that could be used for benefit improvements. The company had given periodic cost of living adjustments and planned to start giving retirees regular "plus ups" every four years to help mitigate the impact of inflation. That, however, was before Maxxam took over Pacific Lumber and stripped more than $50 million in surplus assets from the pension plan.

The Employee Pension Protection Act redefines what is and is not surplus pension money in a very practical way. A company can continue a defined benefit plan and have access to "extra" money as long as that money is not needed to provide an asset cushion to protect the full value of the benefits active workers have earned, and as long as that money is not needed to restore the real value of retirees' pensions.

Approaching the issue in this way seems to us to be conceptually sound. It avoids the unresolvable question of who "owns" the pension money, and does not result in arbitrary splitting of assets that can result in seriously underfunded plans and unjustified "gifts" to employers and employees alike.

The bill also effectively responds to pension industry criticisms of previous proposals, namely that they would have encouraged underfunding of defined benefit plans, or even their termination. The Employee Pension Protection Act provides strong incentives aimed at encouraging employers to continue to maintain well-funded defined benefit plans.

This legislation will, of course, not stop pension plan raids. A great many companies will still be able to take money out of plans. The only situations where companies continuing defined benefit plans will not be able to take out money is where there is, in fact, no true "surplus" in the plan.

Many of the grassroots activists we have been working with around the country would have liked to see this legislation go further. They had hoped Congress would put an end to all raids on plans. They feel strongly that any "extra" money in plans should be used for much needed improvements in their benefits.

Although we would also prefer a total ban on reversions, it has now been five years since the Subcommittee's first hearing on this subject and billions of dollars have been take out of pension plans. It is time for a solution to this problem. We think that the Employee Pension Protection Act represents a solid, well thought out approach, and we applaud you, Mr. Chairman, for taking the initiative to introduce this important, innovative legislation.

Senator **Metzenbaum**. Thank you very much, Ms. Ferguson.

There is some claim that employers in the future would inadequately fund pension plans if they cannot take a 100 percent reversion. Do you have an opinion on that?

Ms. **Ferguson**. My opinion is that I don't think that it is true, nor is it logical. This bill permits employers to take money that they feel is the result of their investment expertise, the result of their taking the risk.

The only money that this bill does not allow employers to take out in a defined benefit plan is money that is needed to fund ongoing plans, and most employers recognize that that money should stay in a plan.

Similarly, it recognizes something that most employers had voluntarily recognized, particularly before the advent of plan raiding. Most large employers did give voluntary adjustments to their retirees. They did try to remedy this defect in the pension system, the fact that it is not indexed for inflation.

So I don't think that they would underfund or do anything else to change their behavior if they were not permitted to take all of the money.

Senator **Metzenbaum**. Do you think employers set up pension plans with the intention that someday they can take reversions?

Ms. **Ferguson**. No, Mr. Chairman. I think employers set up pension plans for many reasons; that is not one of them. One of the most important reasons that employers set up defined benefit plans is because there is no other way that they can provide company officers with $90,000 or more a year, in a situation in which they can also provide credit for all the years those employees have worked for the company, and a situation in which those corporate officers do not take a risk.

I should mention something that has come to our attention recently which I had not realized. The reason there has been less urgency about the cost-of-living adjustment among many corporate executives is that up until very, very recently they were permitted to cash out their money as lump sums and then invest to protect against inflation themselves. That is now changing; the discretion to let executives do this has now been curtailed.

Senator **Metzenbaum**. Do you think this legislation goes far enough?

Ms. **Ferguson**. As I mentioned in my statement, many of our activists feel that it does not, and they are quite outspoken about this. In our view, it is critically important that a resolution of this problem be reached and be reached very, very soon, and as a compromise—and it is exactly that; it is legislation that takes into account everybody's concerns—I would say in that sense as a compromise, as something that I feel very strongly could be enacted quickly, it is as far as possibly we should go under those considerations.

Senator **Metzenbaum**. From your lips to 534 members of Congress, hopefully.

I am going to turn the hearing over to Senator Jeffords, and I will excuse myself for a moment.

Senator **Jeffords**. Thank you very much, Mr. Chairman.

I have an open mind on this legislation at this point. I think my main concern is what is happening to defined benefit plans and the decrease in the desirability of defined benefit plans and the movement away from defined benefit plans.

There has been concern expressed that this legislation will make it less likely that somebody starting a plan will start a defined benefit plan, and I wondered if you feel that that is a legitimate concern, and if not, why not.

Ms. **Ferguson**. That assertion has been made every time there has been a measure to bring greater equity to the private pension system. "If this legislation is passed, we are going to pick up our marbles and go home"; nobody will ever set up a defined benefit plan.

The reality is that defined benefit plans are not being set up because most of the universe of employers, for whom a defined benefit plan is realistic, already have those plans. Smaller companies tend to find the trade-off that goes along with defined benefit plans—defined benefit plans provide very high benefits, and they can be skewed very nicely to longer-service, higher-paid employees—but there is a trade-off for that, and the trade-off is paperwork and complexity.

So smaller employers tend to go to defined contribution plans. That is not necessarily a desirable trend, but I feel very strongly that this legislation is weighted very strongly to keeping those employers who are in the defined benefit plan system—and of course, there are many, and their employees. This legislation is aimed at providing incentives to encourage them to stay in the system, and I think that is a very important aspect of this legislation.

Senator **Jeffords**. In recent years we have had a substantial decline in the number of reversions in excess of $1 million, in any event—I think we reached a peak in 1985 of 582, and it was down to 166 last year. Do you have an opinion as to why this is occurring?

Ms. **Ferguson**. Senator Metzenbaum mentioned very recently that there are now 600 plans waiting to terminate with more than $1 million at the end of the moratorium. There are many factors. Many employers took advantage of the loophole when it first opened up, particularly in 1984, and stampeded to take reversions. I don't know what the reason is, but I would not be surprised if—and we also had a stock market decline—this may go up and down. But I don't think it is a consistent pattern; I don't think you see it trailing off.

Very large reversions are now pending. For example, the American Red Cross is proposing to take $400 million out of their pension plan, a sizeable amount of money.

Senator **Metzenbaum**. Let me just correct one point. I did not say that there were 600 pending each of which was in excess of $1 million. I don't know the dollar amount.

Ms. **Ferguson**. Oh. I am sorry. Okay.

Senator **Jeffords**. I am very concerned about the problem of there being no significant growth in the number of defined benefit plans, and I wonder if you have a feeling as to what the new accounting standards, requiring a listing of unfunded liabilities, are going to do to the desirability of defined benefit plans.

Ms. **Ferguson**. My guess is that it will have very little impact, because everybody has to do it. Any time everybody has to do something, it sort of turns out to be a wash and is discounted, the fact that the liabilities are now part of the statement rather than the footnotes. It is just the way you read the statement now, you know that those are pension liabilities, and you know what they mean. Personally, I don't think it is a significant factor.

Senator **Jeffords**. Jack, do you have a feeling?

Mr. **Guildroy**. No, I have no feeling about that, but if I may comment on your last question——

Senator **Jeffords**. Please.

Mr. **Guildroy** [continuing]. I agree completely with what Karen Ferguson just said about why the number of reversions seem to be declining. I would like to believe—no one can prove this—I would like to believe that the protests on the part of workers, unions, retirees, hearings such as this, are having an effect on employers, that they are thinking twice before jumping into the reversion scheme.

May I also say—and this is very parenthetical, but please permit me to say—I heard one of the witnesses discuss the "golden parachute" syndrome. And frankly, it took me quite a while when I started studying pensions several years ago to understand what "golden parachutes" really are.

It seems to me that the problem for ordinary workers, as I was and millions of other persons still are, the problem is not the color of the parachute or the kind of parachute, but simply that the parachute facing many workers now and many retirees is full of holes. And this is what we are trying to fix, and what you are trying to fix, I am sure.

Senator **Jeffords**. Thank you.

Senator **Metzenbaum**. Thank you very much, Ms. Ferguson, Mr. Guildroy.

Our next witness is Eugene Kalwarski, principal and consulting actuary of Milliman and Robertson, Washington, D.C.

Mr. Kalwarski, it is my understanding that part of your comments will address themselves to the point that I have made that much of the surplus arises from inflation, higher interest rates, higher stock prices. As I understand it, you will actually indicate that you feel it is a built-in surplus that actuaries urge upon employers when they set up the pension plans.

Is that a correct statement of your position?

Mr. **Kalwarski**. Yes, it is, Mr. Chairman. I have a series of four charts, and if our machines work, I can demonstrate that concept.

Senator **Metzenbaum**. Please proceed.

STATEMENT OF EUGENE M. KALWARSKI, PRINCIPAL AND CONSULTING ACTUARY, MILLIMAN & ROBERTSON, INC., WASHINGTON, DC, ACCOMPANIED BY RICHARD LABOMBARDE, CHIEF RESEARCH ACTUARY

Mr. **Kalwarski**. My name is Gene Kalwarski. I am a consulting actuary with Milliman and Robertson, and my purpose here today is not as an advocate nor an opponent to the proposed legislation, but it is simply to be a technical advisor, to provide technical insight in the issue of how a pension plan surplus arises.

Before I go to the first chart, I am going to describe two worlds—an ideal and a real world of funding. In the ideal world, actuaries have crystal balls and can predict year-to-year experience. In the ideal world, employers fund exactly in accordance with our independent conclusions. In the ideal world, the work force is stable, the plans remain indefinite. In the ideal world, Federal laws and accounting standards work perfectly with actuarial theory.

In the real world, that is not true. In the real world, we do not have crystal balls; we do not have the ability to predict year-to-year experience. Employers, knowing that we don't have those crystal balls, make decisions that are influenced by business concerns, often short-term, to either accelerate or delay funding. The work force may in fact be growing or declining, and the plans may be modified or terminated. And finally, the external influences of Federal laws and accounting standards do not always work well with actuarial theory.

With that being said, I am going to go to a chart here that talks about ideal world funding. This is a one-person pension plan that compares the actual cost of a pension benefit based on final pay, which is the red line, what it would actually cost to buy the benefits being earned each year, versus the green line, which is a common actuarial approach, which is to provide more in the early years and less in later years. The purpose of that is to keep the pension cost as a level percentage of payroll.

The next chart shows the development of assets in that very same pension plan. By putting in extra money up front, the green line, which are the assets, will always exceed the red lines, which are the cost of the benefits earned each year and the accumulation of those costs. The red line is more or less the PBGC liability.

What I am saying here is that even in the ideal world there is a built-in surplus that actuaries intentionally create or require in order to keep the funding level.

If we were to go to the real world, the scenario is slightly different. In the real world, the annual cost on the actuarial basis, the green line, is in fact greater, as was before, than the red line, which is the cost of the benefits being earned each year—but it is not level every year. There are benefit increases occurring; there are peaks and valleys; it is a very uncertain world.

When you compare the accumulation of assets in the real world in my fourth chart here, the surplus here is the difference between the top of the green bars and the red bars. And you can see, even with advance funding, there are years where the red bar equals the green bar in which there are no surpluses, and other years where there are substantial surpluses.

In summary what we are saying is that actuarial surpluses derive in great part from expected funding levels.

If you go to the last chart, this is just an example of pension fund surplus, the sources of pension fund surplus. In the average type of plan, I have found that the majority of the surplus is attributable to the method chosen by the actuary. Another major portion is attributable to conservatism by the actuary in the real world. The balance of the surplus, I have found, is attributable to the year-to-year experience fluctuations.

My final comment is that the only concern I would have with legislation in this area is that it not interfere nor create disincentives to sound funding for underfunded plans.

With that, I want to thank this committee for the opportunity to make a presentation and welcome any questions.

[The prepared statement of Mr. Kalwarski follows:]

TESTIMONY OF

EUGENE M. KALWARSKI, F.S.A.
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BEFORE THE

SUBCOMMITTEE ON LABOR
OF THE
SENATE COMMITTEE ON LABOR AND HUMAN RESOURCES

ON THE SUBJECT OF

S.685
THE EMPLOYEE PENSION PROTECTION ACT

TUESDAY, APRIL 11, 1989
AT 10 A.M.
DIRKSEN SENATE OFFICE BUILDING, ROOM 430

Introduction

Good morning. My name is Gene Kalwarski, FSA, MAAA, EA. I am a principal and consulting actuary with Milliman & Robertson, Inc., Consulting Actuaries. We are the fourth largest actuarial consulting firm in the country in terms of number of actuaries, representing thousands of pension plans and employee benefit programs covering millions of plan participants. I personally represent four state-wide systems with aggregate assets of nearly $30 billion. Although public plans are not the issue today, the concern over pension surplus is something with which I am constantly dealing in my work with state legislators.

Assisting me this morning is Richard LaBombarde, ASA, MAAA, EA. Rich is the chief research actuary with Milliman & Robertson. As such, he deals continually with emerging employee benefits issues on the legislative, regulatory, and accounting front.

I am here today neither as an advocate nor an opponent of any proposed rules that this committee is considering. In fact, I would find difficulty in representing either side, given the divergent interests of our clients. My purpose here today is to provide technical insight into the issue of how pension plan surplus can arise.

Pension Funding in the Ideal World Versus the Real World

To understand the development of pension surplus, one must first examine the basic mechanics and dynamics of the on-going funding of pension benefits in the ideal world versus the real world. In the ideal world of pension funding, actuaries have crystal balls and can anticipate future annual experience exactly, so that the actual experience exactly matches the actuary's assumptions. Employers in this ideal world fund their plans in accordance with their actuary's independent conclusions, using a method that equitably allocates benefit costs on a tax-effective basis to different generations of shareholders. Furthermore, the ideal employer has stable workforce characteristics and maintains its pension plan indefinitely. Finally, all external influences, such as federal laws and accounting standards, coordinate perfectly with actuarial theory.

The real world bears only faint resemblance to this ideal. Actuaries cannot predict year-to-year experience, and therefore tend to be conservative. Employers, knowing actuaries do not have crystal balls, make decisions that are influenced by the employer's business concerns, at times concentrating on temporary, short-term business conditions, e.g., either accelerating or delaying the funding. Faced with a complex array of factors, an employer might even seek to modify the pension benefits that are the target of the funding policy, for example by changing the benefit formula or by replacing the defined benefit pension plan with a defined contribution plan. Finally, for various reasons, the regulatory and other external influences do not coordinate well with orderly funding pursuant to an ideal actuarial theory.

Sources of Pension Surplus

This general background can be useful to an examination of the sources and character of surplus assets that remain after the satisfaction of all accrued benefits upon the termination of a pension plan. First, it should be emphasized that pension surplus can arise under the ideal world scenario. Under most actuarial methods, which provide for level allocation of increasing costs, the assets that are accumulated in the early years of an employee's career will always exceed the accumulated liabilities, so that excessively heavy contributions will not be necessary in the years immediately preceding retirement. This feature of advance funding is most notable in plans with benefits directly tied to an employee's final salary, but is present even in non-pay-related plans. In the real world scenario, a significant portion of the pension surplus can be attributed to this same factor.

The remaining portions of pension surplus all have their basis in the difference between the real world and the ideal world, that is, in the difference between the expectations used in funding versus the actual emerging experience. We are taking approximate aim at a moving, changing target without absolute certainty as to where that target is or how it is moving or who is moving it. Notable sources of actuarial surplus that can be characterized by the uncertainty present in the real world include favorable investment performance, salary experience, mortality, workforce mobility, benefit cost-of-living adjustments, plan expenses, etc. The actuary may affect the amount of pension surplus that develops from each of these sources via the expectations used for funding the plan, e.g., higher pension surplus will arise from use of conservative actuarial assumptions. Furthermore, certain employer business decisions may affect the amount of pension surplus that develops from each of these sources, e.g., downsizing of a workforce or selection of the investment policy used by the pension fund.

Basic Conclusions

In any situation, any pension plan that is funded on an actuarially sound basis from inception of the plan should develop a surplus regardless of when it terminates. Additional surplus can arise from differences between actual experience and the expectations used to fund the plan -- for example, favorable investment performance. Similarly, this additional surplus can be reduced or eliminated by adverse experience -- for example, losses on pension fund investments.

My principal concern in describing the actuary's perspective of these issues is that any legislation relating to pension surplus not interfere with, nor create disincentives to, sound actuarial funding of pension plans, particularly those that are underfunded.

Closing Remarks

We would appreciate the opportunity to extend our remarks for the record on the issues we have addressed in this brief overview. Also, we have attached to our written comments an appendix which summarizes some other key issues which should be considered in legislation that deals with pension surplus. We thank you for the privilege of appearing before you this morning and welcome any questions.

* * *

Addendum

Additional Issues Relating to Treatment of Pension Surplus

The following material summarizes some additional issues which should be considered in the development of legislation that would affect the treatment of pension surplus. This summary is not intended to advocate or oppose any particular legislative initiative relating to pension surplus.

- General retirement income policy.
  - Voluntary pension system versus mandatory system.
  - Encouragement of establishment and maintenance of defined benefit pension plans.
  - Stability of legal environment.

- Basic definition of pension surplus.
  - Definition of accrued benefits and the employer's benefit commitment.
    - On-going funding target versus termination liabilities.
    - Definition of benefit liabilities, including accrual of ancillary benefits.
    - Assumptions to be used in measuring pension surplus.

        - Use of fractional rule of accrual.
    - Sources of pension surplus.
        - Funding method.
        - Funding assumptions.
        - External factors and decisions, e.g., reduction of benefit accrual rate.
    - Definition of "actuarial error."

- General coordination with pension funding policies.
    - Correlation between treatment of surplus assets, the full funding limitation, and minimum funding standards.
    - Effect of treatment of pension asset surplus on employer behavior with respect to advance funding of defined benefit plans.

- Coordination with controlled pension funding policies.
    - Defense contractors.
    - Utilities and other employers subject to regulatory supervision of rates.

- Taxation of reversion of surplus pension assets.
    - Technical details.
        - Definition of surplus against which the excise tax applies.
        - Parties liable for excise tax.
        - Rate(s) of excise tax.
        - Exemptions for transfers (e.g., to defined

contribution accounts or 401(h) accounts).

- Treatment of tax-exempt employers.

o Correlation with takeover activity.

- Use of surplus pension assets to fund takeover.
- Use of surplus assets as anti-takeover device.

o Other considerations.

- Establishment of successor retirement savings arrangement.
- Limitations on employee share of surplus under IRC 415.
  - Overall limitations (e.g., restriction for certain HCEs).
  - Participation phase-in.
  - On-going inclusion of employee share in future IRC 415 calculations.
- Form of receipt of employee share of surplus (e.g., cash, annuity).
- Controlled group issues.
- Accounting.

* * *

Senator **Metzenbaum**. Your last comment is that we not create disincentives to the establishment of soundly-funded plans. Do you think our legislation does that?

Mr. **Kalwarski**. I do not know. It is not just this legislation, but perhaps a combination of all prior legislation does that—but my point being that I do not believe this legislation would create disincentives to funding for the currently well-funded plans. It may perhaps, on your very poorly-funded plan, give the employer who is having financial difficulties another element of pressure to apply on the actuary to reduce costs.

Senator **Metzenbaum**. If an employer terminates its pension plan, removes all assets in excess of termination liability and then sets up an identical plan, is that new plan adequately funded to pay promised benefits?

Mr. **Kalwarski**. Under the current proposed legislation, or the current situation?

Senator **Metzenbaum**. Current situation.

Mr. **Kalwarski**. The plan is less funded than it would have been otherwise. What is adequately funded, I have yet to define.

Senator **Metzenbaum**. But actuarially, is it adequately funded under those circumstances?

Mr. **Kalwarski**. To me, an adequately funded plan is not the snapshot of where it stands at a particular point, but the process of how the plan funds over years. If this were a repeat scenario, happening every five or six years, I might have a different answer than if this were a one-time occurrence.

Senator **Metzenbaum**. As I understand, employers generally fund pension benefits in order to pay projected benefits. If Congress decides that a cushion should be kept in a new plan, is it actuarially sound to base that cushion on projected benefits?

Mr. **Kalwarski**. We are approaching an area of more policy than actuarial, but I will say that any legislation that is tied to actuarial methods as opposed to termination methods is preferable.

There is current legislation in the full funding area that is applied to the termination liability, and it has created havoc in the funding of our plans and has created great disincentives for funding.

Senator **Metzenbaum**. If you were a member of Congress, would you support the concept that any new plan should have a built-in cushion in it?

Mr. **Kalwarski**. I do not have an answer right now on that. Again, I have seen both sides of the issue, and I would have great difficulty judging the pros and the cons.

Senator **Metzenbaum**. Let me ask you this question. Don't you as an actuary advocate a built-in cushion?

Mr. **Kalwarski**. Over time, I do. When the plan first starts, there is no cushion. A brand new plan starting today with no assets would not have that cushion.

Senator **Metzenbaum**. But if you take a plan that is terminating and that has a very substantial cushion in it and then start a new one——

Mr. **Kalwarski**. I would prefer to have a cushion.

Senator **Metzenbaum**. You would prefer to have a cushion.

Is a surplus necessary for the actuarially-sound funding of a pension plan?

Mr. KALWARSKI. "Surplus" being defined as what?

Senator METZENBAUM. Well, you are reading the lips of Senator Jeffords, because Senator Jeffords just said, very softly, "It depends upon how you define 'surplus'." I did not know that you could do that so well. [Laughter.]

I define a surplus as that amount in excess of that which you would project on an actuarial basis, without any allowance for inflation or any other kind of cushion.

Mr. KALWARSKI. Surplus based on the projected benefit which you are funding.

Senator METZENBAUM. Yes.

Mr. KALWARSKI. I apologize—the question?

Senator METZENBAUM. Is a surplus necessary under those circumstances in order to be actuarially sound?

Mr. KALWARSKI. Again, I am not trying to be wishy-washy, an actuarial surplus—I cannot define it at a single point in time.

Senator METZENBAUM. I will withdraw the question.

Mr. KALWARSKI. Thank you.

Senator METZENBAUM. To the extent that ongoing pension plans have benefitted from better than expected investment returns, are employers in a position to take advantage of that fact—as Mr. Bahr had indicated employers' failure to put anything additional into the fund since 1986. Can an employer take advantage of the increased dollars in the fund to cut back on its own contributions?

Mr. KALWARSKI. The employer is at risk for both better than average or below average investment earnings, and in either case his contributions will increase or decrease. But as you saw from my last chart, I do think there may be an overemphasis on the impact investments have on the surplus situation. I think it is the choice of the funding and the conservatism of the actuary in many cases that creates the surplus.

Senator METZENBAUM. Thank you.

Senator Jeffords?

Senator JEFFORDS. Your last chart intrigued me with that large method selection part of the pie. Would you give me a little bit better idea what the methods were that resulted in that being such a large part of the pie?

Mr. KALWARSKI. There are basically four or five generally-used actuarial funding methods; they are quite technical—they are called things like entry-age normal and aggregate funding—and they are all based on a concept of projecting a benefit at retirement with salary increases as well as future service credits. That produces, obviously, a much higher method than a funding method that each year pays the benefit that is earned that year.

So if you will remember my first chart, the costs were much higher in the green lines and the red lines than the surplus that is being generated from the choice of the projected funding method. We pay more up front so that we have more money at any point in time, so we do not have to pay as much later. That creates in most cases the majority of the surplus.

Senator **Jeffords**. Would that be an actuarial decision, which would result in more funding up front, or is that a business policy decision?

Mr. **Kalwarski**. It is supposed to be in theory in the ideal world, a purely actuarial decision. And in the real world, since there is no right answer, the actuary in a single-employer plan will work with management to arrive at funding objectives that adequately fund the program; with a multi-employer, you have a joint board of trustees, and that decision is shared, so it is not solely on the actuary's shoulders.

Senator **Jeffords**. Thank you, Mr. Chairman.

Senator **Metzenbaum**. Thank you, Senator Jeffords.

Mr. **Kalwarski**. Mr. Chairman, with me is Richard LaBombarde, Chief Research Actuary for our firm, who did quite a bit of the work leading up to this testimony.

Senator **Metzenbaum**. We are very grateful to you for your participation, your cooperation and your ability to explain some aspects of this entire matter to us. Thank you.

Mr. **Kalwarski**. Thank you.

Senator **Metzenbaum**. Our next and final witness is Mr. Chester Labedz, Jr., Benefits Counsel, Textron, Inc., speaking on behalf of the ERISA Industry Committee, Washington, D.C.

Mr. Labedz, let me tell you my own time schedule. It is about 28 minutes after 11:00. I have an appointment at 11:45 that I must keep. So you have time to make your presentation and leave me a little time and then Senator Jeffords a little time to ask you some questions.

Mr. **Labedz**. I am sure we can handle that very easily, Senator.

Senator **Metzenbaum**. Thank you. Please proceed.

STATEMENT OF CHESTER S. LABEDZ, JR., BENEFITS COUNSEL, TEXTRON, INC., ON BEHALF OF ERISA INDUSTRY COMMITTEE, WASHINGTON, DC, ACCOMPANIED BY JOHN VINE, COVINGTON & BURLING, ERIC COUNSEL

Mr. **Labedz**. Mr. Chairman, Senator Jeffords, and members of the subcommittee, my name is Chester Labedz. I appear today on behalf of the ERISA Industry Committee, commonly known as ERIC. I serve as chairman of ERIC's Title IV Task Force, and I am benefits and compensation counsel at Textron, Inc.

With me today is John Vine, of Covington and Burling, who is ERIC counsel.

Let me depart briefly from my prepared remarks to emphasize that the present system of pension funding has paid millions of pensioners billions of dollars successfully over the years. So as we talk about the issues before us today, let's realize just how good a job the present system is doing.

ERIC strongly opposes S. 685. The bill will inflict great harm on retirees, employees and beneficiaries and on pension plans in general. It will deter strong funding, reduce employees' retirement security, discourage the formation and expansion of new defined benefit plans and impose additional financial risks on the Pension Benefit Guaranty Corporation.

If the bill is enacted, employers will, over the long term, reduce their plan contributions to the minimum level allowed by ERISA's minimum funding standards. If a plan's excess assets have to be used to provide benefits which exceed what the employees have been promised, the employers' stockholders are not likely to tolerate a management that contributes more to the plan than the minimum the law requires.

The Pension Protection Act of 1987 made great strides in strengthening the minimum funding standards for pension plans. ERIC supported that legislation and very actively participated in the process that led to its enactment.

By encouraging employers to contribute only the minimum that the law requires, S. 685 reverses the gains made by the Pension Protection Act and promotes weaker pension funding. As a result, the bill significantly increases the risks that inadequately-funded plans impose on employees, retirees, the PBGC and the economy as a whole.

The lessons we have learned from the recent experience with poorly-funded plans make it evident that S. 685 will seriously damage the financial security of private pension plans and the workers, retirees and families who count on them.

The bill also will impose for the first time federally-mandated benefits upon private sector employers. In our view, the bill represents a back door effort to mandate cost-of-living increases for all retirees and beneficiaries. We strongly oppose this effort.

By imposing federally-mandated benefits, the bill is fundamentally inconsistent with the successful voluntary system that the Nation has enjoyed for many years. By specifying the benefits that must be provided after a plan terminates, the bill stifles the flexibility and innovation that has enabled private pension plans to expand and to meet the needs of workers and retirees.

It interferes with the rights of management and labor to negotiate the benefits that best fit their needs.

Although the bill purports to give an employer the opportunity to recover a portion of a terminated plan's excess assets, our calculations indicate that this is only an illusion. The bill will prohibit most, if not all, employers from recovering any excess assets from a terminated plan.

In addition, the bill fails to resolve the serious Federal income tax issues which it raises. For example, the bill fails to take into account the fact that the employer's successor plan will be subject to the Internal Revenue Code's deduction limits and spousal annuity requirements and the fact that the Code's spousal annuity requirements do not apply at this time to IRAs. These issues should be addressed by the Senate Finance Committee.

The bill also is completely inconsistent with the legal requirements that apply to employers who contract with the Federal Government. The bill will put a Government contractor in the position of being required to give a plan's excess assets both to the Federal Government and to its own employees at the same time. This result is absurd and must be corrected.

Moreover, the bill requires terminating plans to eliminate the employees' valuable lump sum distribution rights which occur under a number of plans. This is contrary to the anti-cutback provisions of the Internal Revenue Code and ERISA. There is no justification for this cutback on employee rights.

Finally, the bill imposes draconian penalties on the fiduciaries of a plan that violates the bill's requirements. The bill imposes liability on a fiduciary who did not have any responsibility for or knowledge of the violation, and even imposes liability on an individual who ceases to be a fiduciary before the violation occurs. There is no justification for this punitive role.

Mr. Chairman, we thank you for giving us the opportunity to present our views to the subcommittee. We will be happy to respond to any questions that you or Senator Jeffords have.

[The prepared statement of Mr. Labedz follows:]

ERIC

The
ERISA
Industry
Committee

ORAL STATEMENT OF
CHESTER S. LABEDZ
ON BEHALF OF THE
ERISA INDUSTRY COMMITTEE

* * *

THE EMPLOYEE PENSION PROTECTION ACT OF 1989
APRIL 11, 1989

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, MY NAME IS CHESTER S. LABEDZ. I APPEAR TODAY ON BEHALF OF THE ERISA INDUSTRY COMMITTEE, COMMONLY KNOWN AS ERIC. I SERVE AS CHAIRMAN OF ERIC'S TITLE IV TASK FORCE. I ALSO SERVE AS COMPENSATION AND BENEFITS COUNSEL TO TEXTRON INC.

WE HAVE FILED A WRITTEN STATEMENT WITH THE SUBCOMMITTEE, AND WE ASK THAT IT BE INCORPORATED IN THE RECORD.

ERIC STRONGLY OPPOSES S. 685. THE BILL WILL INFLICT GREAT HARM ON EMPLOYEES, RETIREES, AND BENEFICIARIES, AND ON PENSION PLANS IN GENERAL. THE BILL WILL DETER SOUND FUNDING, REDUCE EMPLOYEES' RETIREMENT SECURITY, DISCOURAGE THE FORMATION AND EXPANSION OF NEW DEFINED BENEFIT PLANS, AND IMPOSE ADDITIONAL FINANCIAL RISKS ON THE PENSION BENEFIT GUARANTY CORPORATION.

IF THE BILL IS ENACTED, EMPLOYERS WILL, OVER THE LONG TERM, REDUCE THEIR PLAN CONTRIBUTIONS TO THE MINIMUM LEVEL ALLOWED BY ERISA'S MINIMUM FUNDING STANDARDS. IF A PLAN'S EXCESS ASSETS MUST BE USED TO PROVIDE BENEFITS THAT

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EXCEED WHAT THE EMPLOYEES HAVE BEEN PROMISED, THE EMPLOYER'S STOCKHOLDERS ARE NOT LIKELY TO TOLERATE A MANAGEMENT THAT CONTRIBUTES MORE TO THE PLAN THAN THE MINIMUM THE LAW REQUIRES.

THE PENSION PROTECTION ACT OF 1987 MADE GREAT STRIDES IN STRENGTHENING THE MINIMUM FUNDING STANDARDS FOR PENSION PLANS. ERIC SUPPORTED THAT LEGISLATION AND ACTIVELY PARTICIPATED IN THE PROCESS THAT LED TO ITS ENACTMENT.

BY ENCOURAGING EMPLOYERS TO CONTRIBUTE ONLY THE MINIMUM THAT THE LAW REQUIRES, S. 685 REVERSES THE GAINS MADE BY THE PENSION PROTECTION ACT AND PROMOTES WEAKER PENSION FUNDING. AS A RESULT, THE BILL SIGNIFICANTLY INCREASES THE RISKS THAT INADEQUATELY-FUNDED PLANS IMPOSE ON EMPLOYEES, RETIREES, THE PENSION BENEFIT GUARANTY CORPORATION, AND THE ECONOMY AS A WHOLE. THE LESSONS WE HAVE LEARNED FROM THE RECENT EXPERIENCE WITH POORLY-FUNDED PLANS MAKE IT EVIDENT THAT S. 685 WILL SERIOUSLY DAMAGE THE FINANCIAL SECURITY OF PRIVATE PENSION PLANS AND THE WORKERS, RETIREES, AND FAMILIES WHO COUNT ON THEM.

THE BILL ALSO WILL IMPOSE, FOR THE FIRST TIME, FEDERALLY-MANDATED BENEFITS UPON PRIVATE-SECTOR EMPLOYERS. IN OUR VIEW, THE BILL REPRESENTS A BACK-DOOR EFFORT TO MANDATE COST-OF-LIVING INCREASES FOR ALL RETIREES AND BENEFICIARIES. WE STRONGLY OPPOSE THIS EFFORT.

BY IMPOSING FEDERALLY MANDATED BENEFITS, THE BILL IS FUNDAMENTALLY INCONSISTENT WITH THE SUCCESSFUL VOLUNTARY SYSTEM THAT THE NATION HAS ENJOYED FOR MANY YEARS. BY SPECIFYING THE BENEFITS THAT MUST BE PROVIDED AFTER A PLAN TERMINATES, THE BILL STIFLES THE FLEXIBILITY AND INNOVATION THAT HAS ENABLED PRIVATE PENSION PLANS TO EXPAND AND TO MEET THE NEEDS OF WORKERS AND RETIREES, AND INTERFERES WITH THE RIGHTS OF MANAGEMENT AND LABOR TO NEGOTIATE THE BENEFITS THAT BEST FIT THEIR NEEDS.

ALTHOUGH THE BILL PURPORTS TO GIVE AN EMPLOYER THE OPPORTUNITY TO RECOVER A PORTION OF A TERMINATED PLAN'S EXCESS ASSETS, OUR CALCULATIONS INDICATE THAT THIS IS ONLY AN ILLUSION. THE BILL PROHIBITS MOST IF NOT ALL EMPLOYERS FROM RECOVERING ANY EXCESS ASSETS FROM A TERMINATED PLAN.

IN ADDITION, THE BILL FAILS TO RESOLVE THE SERIOUS FEDERAL INCOME TAX ISSUES THAT THE BILL RAISES. FOR EXAMPLE, THE BILL FAILS TO TAKE INTO ACCOUNT THE FACT THAT THE EMPLOYER'S SUCCESSOR PLAN WILL BE SUBJECT TO THE INTERNAL REVENUE CODE'S DEDUCTION LIMITS AND SPOUSAL ANNUITY REQUIREMENTS AND THE FACT THAT THE CODE'S SPOUSAL ANNUITY REQUIREMENTS DO NOT APPLY TO IRAS. THESE ISSUES SHOULD BE ADDRESSED BY THE SENATE FINANCE COMMITTEE.

THE BILL ALSO IS COMPLETELY INCONSISTENT WITH THE LEGAL REQUIREMENTS THAT APPLY TO EMPLOYERS WHO CONTRACT WITH

AGENCIES OF THE FEDERAL GOVERNMENT. THE BILL WILL PUT A GOVERNMENT CONTRACTOR IN THE POSITION OF BEING REQUIRED TO GIVE ALL OF A PLAN'S EXCESS ASSETS BOTH TO THE FEDERAL GOVERNMENT AND TO ITS OWN EMPLOYEES AT THE SAME TIME. THIS RESULT IS ABSURD AND MUST BE CORRECTED.

MOREOVER, THE BILL REQUIRES TERMINATING PLANS TO ELIMINATE EMPLOYEES' VALUABLE LUMP-SUM DISTRIBUTION RIGHTS, CONTRARY TO THE ANTI-CUTBACK PROVISIONS OF THE INTERNAL REVENUE CODE AND ERISA. THERE IS NO JUSTIFICATION FOR THIS CUTBACK ON EMPLOYEE RIGHTS.

FINALLY, THE BILL IMPOSES DRACONIAN PENALTIES ON THE FIDUCIARIES OF A PLAN THAT VIOLATES THE BILL'S REQUIREMENTS. THE BILL IMPOSES LIABILITY ON A FIDUCIARY WHO DID NOT HAVE ANY RESPONSIBILITY FOR, OR KNOWLEDGE OF, THE VIOLATION, AND EVEN IMPOSES LIABILITY ON AN INDIVIDUAL WHO CEASES TO BE A FIDUCIARY BEFORE THE VIOLATION OCCURS. THERE IS NO JUSTIFICATION FOR THIS PUNITIVE RULE.

MR. CHAIRMAN, WE THANK YOU FOR GIVING US THE OPPORTUNITY TO PRESENT OUR VIEWS TO THE SUBCOMMITTEE. WE WILL BE HAPPY TO RESPOND TO ANY QUESTIONS THAT YOU OR THE OTHER MEMBERS OF THE SUBCOMMITTEE MIGHT HAVE.

Senator **Metzenbaum**. Thank you for a very good presentation, Mr. Labedz.

Let me say this to you. If there is anything you have convinced me of—and maybe should have convinced yourself of—it is that it is time for the employer spokespersons to come forward and negotiate with the Congress. But instead of that, I have been around here long enough to see the worst legislation passed, because employers or labor unions or the pharmaceutical industry or the grocery industry or doctors or hospitals—whatever the case may be—who take an intransigent position—no negotiation, no discussion, it is impossible.

We have been trying for five years to discuss with the employers of this country this issue. And you cannot sit there and tell me that employers, such as the company that came in and dissolved the A&P plan and took more money out of it than they paid for the whole company, the German company that came in and did it, that that was right.

You cannot tell me that some of the other terminations that have occurred in this country have been right.

You have to have a sense of embarrassment if you have any sense of decency, when people come before you and tell you they have worked 25 and 30 and 35 years and get $200 or $300.

You are a reasonable man; you are an intelligent man. You are represented by able counsel here. But it is time for the employers to say, "Come, let us reason together." We have been trying to do that for five years.

I have said to the ranking minority member of this committee that we are prepared to reason with you—but we cannot get a peep out of you. All we get out of you is some technical stuff, saying it would create technical problems with the IRS. Come on—stand before us and negotiate with us. We will work out the technical problems. Do not tell me it is a problem that is impossible to work out.

Mr. **Labedz**. Mr. Chairman, I know as chairman of the ERIC Title IV Task Force that I personally have been involved in negotiations on this issue for about four years. And I do not believe it is characteristic of ERIC's position that we have been unwilling to talk with anyone or to work toward effective legislation.

We do not feel for a number of reasons that this will be the effective legislation, because it ignores so many important points.

You have spoken about employee expectations and fairness, and we certainly are very sympathetic to the statements you have made. On the other hand, the present law, the present expectations that employers have about how the pension system works, are the linchpin of the currently successful defined benefit plan system in the United States.

Senator **Metzenbaum**. Mr. Labedz, would you be willing to negotiate with us to figure out some procedure to restrict the massive taking out of billions of dollars from pension plans that are overfunded without any consideration for cost-of-living adjustments to the retirees or the present employees? Would you be willing to negotiate just that subject?

Mr. **Labedz**. We would certainly be willing to work with you in adapting the bill to one that better suits and satisfies all of the issues that I have raised this morning. Some of the issues will be very difficult to satisfy, including the funding issues. But we are certainly willing to work with the committee.

We regret that we have had no opportunity to do this in this particular case because the bill has been furnished to us so recently. But we would certainly be willing to work with your staff, yes.

Senator **Metzenbaum**. What would ERIC propose to restrict unfair reversions—massive reversions, many taking place by reason of LBOs, takeovers by strangers who come in and just say they are going to take over the company and then immediately, as soon as they get there, terminate the pension plan. I think the Texaco-Getty one may fit into that category, and then the Star takeover of Texaco after that.

Mr. **Labedz**. The LBO situation is a special one, certainly, and is worthy of further consideration, and I understand that is happening in other hearings.

Let me testify from a personal perspective that my company has acquired two large companies in the last five years, and in no event have we terminated a major plan that was essential for the ongoing benefit of a large number of employees and recovered anything. Those people are folded right into our benefit structure.

So it does not happen across-the-board, and it happens much less frequently than has been alleged here this morning.

Senator **Metzenbaum**. Mr. Labedz, I just asked my staff whether they had talked with you—I am not sure with you, personally, but with ERIC—and they indicated that they had talked with you about two months ago, and at that point it was indicated that you would be ready to talk in four months.

Were you the party who gave that response?

Mr. **Labedz**. I do not believe so, no. I do not speak for ERIC except in this testimony.

Senator **Metzenbaum**. I see.

Mr. **Labedz**. My point simply was that the first time I got to read the bill was sometime last week.

Senator **Metzenbaum**. You are correct in that. We did not finalize what was going to be in the bill. We had hoped to be able to negotiate something with the Administration as well as with the employers.

Mr. **Labedz**. Let me just point out in connection with that how hard it is for us to testify. We may not be reading it correctly, but we think a fair reading of the bill suggests that an employer has to set aside more than 200 percent of benefit liabilities in order to terminate a plan and create a follow-up plan. That is because it has to satisfy its liabilities under the current plan which is being terminated and then to provide for a cushion of 125 percent under the follow-up plan.

Senator **Metzenbaum**. Let me say this to you, Mr. Labedz. I am not going to tell you that I think the bill I have introduced is perfect. But I know this, that as long as I have been around here, the best legislation has been that legislation that came about when parties who had an interest in the subject sat down and negotiated and worked out the legislation—the Antitrust Procedure Improvement Bill was one that I can think of; the bill providing for the right of corporations to work together on research and not to violate the antitrust laws is another one. I can think of a number of them.

I think some of the worst legislation comes about when we go out there on the floor, and we win it by one vote. And I would just say to you that we are going to make every possible effort to move this bill. If we are not successful on Monday, we will be working on something different on Tuesday. But we would like to negotiate with you—not a month from now—today; tomorrow. We are ready, we are available. My staff is prepared to talk with you, and if that does not work and you want to meet with me, I am prepared to meet with you. And I feel confident that I can get Senator Jeffords into the meeting as well.

We would like to have this matter resolved before billions of dollars more are taken out of these pension plans.

Mr. LABEDZ. We would welcome the opportunity to talk with you, Mr. Chairman.

Senator METZENBAUM. So I would look forward to meeting with you shortly.

Mr. LABEDZ. Let me just point out that I found something very interesting in Mr. Kalwarski's presentation up here. It goes to employees' expectations of a surplus—and I do not mean to be argumentative here—but I found it eye-opening that about 45 percent of what we are talking about in terms of surplus was simply a question of which of five highly technical actuarial methods were used to fund the plan.

I think that to a certain extent puts in perspective the issue of employee expectations to all the money that is going in on a 42-cents-an-hour basis, whatever the case may be.

Let me point out one other thing. A thing that we have had problems with in terms of the bill has been the provision for cost-of-living increases. And in that respect let me liken it to the situation that now faces unfunded medical plans.

As you know, the costs of medical plans have skyrocketed, are out of control, and will face us in a couple of years in financial statement reporting. Now, there are two differences between the pension system and the medical system. One, employers, of course, have had the ability to prefund on a tax advantaged basis on the pension side. But secondly, employers have been able to keep control of their pension costs over the years because they controlled the factors. They may have controlled them jointly with labor, but they controlled the factors. To introduce cost-of-living increases into the pension system is to add the one variable, the destabilizing variable, that has so rocked the medical care side, which is inflation. It may be medical care inflation on the medical side, but it is inflation nonetheless. And that is something we have no control over—perhaps no one does, but certainly the members of Congress have an equal stake in controlling that.

Senator METZENBAUM. It is a subject that obviously should be addressed. As to whether we address it in the proper way, or whether there is some way that we can meet the challenge without doing that which concerns you most, I do not know. But I would say to you again we ought to try to work together to do something about it.

Mr. LABEDZ. Certainly.

Senator **Metzenbaum**. Senator Jeffords—and I want to say in turning the questioning over to Senator Jeffords, I may have to leave, but if I do, I will just ask Senator Jeffords to close down the hearing. I thank you very much.

[Additional material supplied for the record follows:]

APPWP
Association of Private Pension and Welfare Plans

April 11, 1989

The Honorable Howard Metzenbaum
Chairman
Senate Labor Subcommittee
607 Hart Senate Office Building
United States Senate
Washington, D.C. 20510

Re: S. 685, Pension Reversions

Dear Mr. Chairman:

The Association of Private Pension and Welfare Plans (APPWP) wishes to take this opportunity to comment on your bill, S. 685, which restricts the ability of employers to retain surplus assets from terminated pension plans. This letter is intended as a supplement to the extensive testimony that we provided on the issue of pension reversions at the Subcommittee on Labor's hearings on February 9, 1989. We request that this letter be included as part of the official hearing record for the follow-up hearings to be held today.

The APPWP is the national trade association for companies and employee benefits professionals concerned about federal legislation and regulations affecting all aspects of the employee benefits system. The APPWP membership of more than 400 companies and benefits professionals represents the entire spectrum of the private pension and employee benefits community: Fortune 500 firms, insurance companies and actuarial, accounting, consulting, investment, banking and other firms.

S.685 WOULD UNDERMINE THE PRIVATE PENSION SYSTEM

The APPWP membership is very concerned that S. 685, if enacted into law, will serve as yet another blow to the health and integrity of the private pension system. The APPWP and its members are dedicated to the goal of ensuring well-funded defined benefit pension plans. Regrettably, the affect of S. 685 will be contrary to this objective. The bill will discourage employer-sponsors of pension plans from funding their plans as adequately as they do under current law; and the bill represents a significant departure from decades of tradition in the private pension system by imposing the will of Congress into the determination of the level of benefits to be provided to participants of employer-provided pension plans. Such decisions have always been -- and appropriately should be -- determined by direct negotiations between employers and employees, not by legislators. By breaking this tradition, S.685 is tantamount to Congress granting a "gift" of employers' money to plan participants.

For a comprehensive discussion of why restrictions on the employer's right of reversion will discourage generous funding of pension plans, we refer you to the APPWP February 9, 1989 statement before this Subcommittee. In sum, the right of reversion recognizes that in order to encourage employers to responsibly and generously fund their pension plans, the employer must be permitted to retain the right to surplus assets remaining following a termination in which all promised benefits to plan participants are paid. Otherwise, employers will be penalized for having prudently invested pension plan assets with the result that such assets earned more than was needed to pay plan obligations.

Even more significantly, the provisions of S. 685 which require an employer to calculate projected benefit obligations for plan participants and to pay mandatory cost-of-living adjustments to retirees, are a radical departure from the nature of our voluntary, private pension system and virtually ensure that almost no company will ever retain surplus assets from a terminated plan -- even if an identical successor defined benefit plan is established following termination.

PROJECTED BENEFIT OBLIGATIONS: TWISTING THE PENSION PROMISE

Projected benefit obligations are, by definition, based on speculation regarding an employee's future employment with a company. To require a company to determine projected benefit obligations and then fund a successor pension plan with a cushion based upon such calculations is akin to setting aside future wage increases for current employees who may leave one's employment totally at their will at any time in the future. The very nature of the "pension promise" guaranteed by the Employee Retirement Income Security Act, is for employers to set-aside, at their own financial risk, sufficient assets to pay the benefits promised to plan participants based upon their actual years of service. To expect employers to set-aside funds for future unknown service by an employee goes far beyond the original "pension promise" and can only lead employers to abandon their support for defined benefit plans entirely, or to provide scant benefits under such plans.

COST-OF-LIVING ADJUSTMENTS - A "GIFT" OF EMPLOYERS' FUNDS

The requirement that cost-of-living adjustments be paid to current retirees upon plan termination is even less defensible. Clearly, retirees are receiving all benefits for which they negotiated during their working years and which their employers have promised. Those retirees who do receive ad hoc cost-of-living adjustments are participants in plans, typically well-funded, in which the employer either negotiates for, or voluntarily chooses to boost the pension payment. Moreover, even where such adjustments are made, it is extremely unusual for full inflation-adjusted increases to be granted as required by S. 685.

Not only would the cost-of-living adjustments be enormously expensive, essentially using up any surplus that might otherwise revert to employers, but the mandatory nature of such adjustments would interfere with the traditional freedom of workers and their employers to negotiate for the level of benefits to be provided.

The mandatory cost-of-living "gift," in conjunction with the projected benefit obligation "gift," legislatively forces employers to give plan participants benefits that exceed a level for which workers and employers have negotiated.

CONCLUSION

The harsh and costly redirection of pension policy encompassed in S.685 will only serve to discourage employers from continuing or establishing benefit plans. That result would be contrary to the goals of a healthy private pension system that the Congress, the business community and employees and retirees all share. Therefore, we urge you not to proceed with consideration of S. 685 and, again, repeat our offer made during the February 9th hearing and in subsequent meetings with Subcommittee staff, to work with you to address concerns that you may have with respect to plan terminations and reversions.

Sincerely,

Howard C. Weizmann
Executive Director

cc: Members, Committee on
Labor and Human Resources

U.S. Chamber of Commerce

1615 H Street, N.W.
Washington, D.C. 20062
202/463-5602

Albert D. Bourland
Vice President
Congressional Relations

April 24, 1989

The Honorable Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce and trade and professional associations, appreciates the opportunity to express its views on S. 685, the Employee Pension Protection Act of 1989. The Chamber opposes this bill because it would limit an employer's ability to recover surplus assets from a terminated pension plan after all accrued-benefit liabilities have been satisfied.

The Chamber remains committed to fostering the growth and stability of a privately sponsored, well-funded pension system. S. 685, by discouraging generous funding and, indeed, commitment to the defined-benefit system, would undermine rather than support retirement income security. The Chamber's reasons for this belief follow.

Benefit Liabilities: As you know, current law prohibits an employer from terminating a pension plan unless all benefits accrued as of the termination date are fully vested and distributed or connected to an annuity. S. 685 would transform the definition of benefit liabilities and contradict the pension promise specified in the plan document. In addition to projected plan liabilities, a substantial "cushion" is required. Such an additional benefit goes well beyond what plan sponsors originally envisioned or promised.

The goal of this "cushion," as the Chamber understands it, is twofold: first, to protect employees against economic vicissitudes, such as inflation and stock market downturns; and second, to ensure that employee expectations about retirement income are met, even when these expectations exceed the stated provisions of the plan.

With respect to the first of these goals, the Chamber shares your concern for retirement income security. However, the Chamber does not share the view that it is solely the responsibility of an employer to shield its employees from economic reality. It should be emphasized that a defined-benefit plan sponsor, by bearing the investment risk associated with plan assets and obligations, already provides a shield not available to private investors or to participants in defined-contribution plans.

Benefits under a defined-benefit plan are calculated according to a specific formula. Regardless of actuarial assumptions chosen or investment performance, the plan sponsor must provide the level of benefit prescribed by that formula. The employee gains the security of knowing, at any given time, the level of benefit to which he is entitled. In return for this predictability, the employee does not have any reasonable grounds for expecting the benefits received to be greater than those promised.

With respect to employee expectations, please note that employers that established pension plans originally expected to provide benefits to employees at the close of lifelong careers with the company. In reality, this is by no means always the case. An employee is free to leave the company, for a variety of reasons, at any point, and still receive accrued vested benefits. An employer cannot prevent an employee from exercising this freedom because of its expectations about future service.

This is as it should be in a free society. However, an employer should be entitled to similar flexibility. If it determines that maintaining a defined-benefit plan no longer is feasible or sensible in light of a changing business environment, it should be able to terminate that plan without reference to potential salary increases potentially earned over a potential period of future service.

Mandated Benefits: S. 685 would further mandate that the sponsor of a plan to be terminated provide a cost-of-living adjustment to its retirees, to the full extent of the increase in the Consumer Price Index from the date of retirement through the date of plan termination. Mandated benefits of any kind are a drastic departure from the voluntary nature of the private pension system. Worse, this mandate hurts those employers that have voluntarily chosen to provide retirement benefits to their employees. Indeed, such a requirement would discourage the formation of defined-benefit plans.

The resources that a company has available to provide benefits to its employees are not magically increased by specifying the form in which they must be spent. A mandated benefit increase to retirees may well result in decreased dollars available for active employees. It is not difficult to foresee the eruption of an intergenerational conflict that endangers the pension system as a whole.

Asset Recovery by Employer: An employer that terminates a pension plan without establishing a successor plan would be barred from recovering any surplus assets, even though valid business reasons may preclude the establishment of a new plan. For example, an employer's decision to terminate a plan may be motivated by its intention to close down a line of business or by its need for cash to keep the business in operation. Frequently, the issue of asset reversions will be tangential to a plan termination decision. S. 685 is based on the incorrect assumption that surplus assets always primarily motivate plan terminations.

Even with a successor plan, S. 685 would grant an employer the right to only such funds as may remain after fulfillment of additional obligations never promised or agreed to by the plan sponsor.

Pension Regulation: The Chamber's annual survey of employee benefits indicates that a shift away from defined-benefit plans has begun. Further, the Chamber has heard from an increasing number of its members that their attorneys and consultants have advised them to avoid defined-benefit plans. Passage of S. 685 would increase this growing trend.

The Chamber believes that the costly and unrealistic shift in pension policy represented by S. 685 will discourage employers from establishing defined-benefit plans and from sound funding of existing plans. Such a blow to the private pension system will injure workers, plan beneficiaries and society as a whole.

The Chamber respectfully requests that this letter be included in the hearing record on S. 685.

Sincerely,

Albert D. Bourland

cc: Members of the Subcommittee on Labor
James J. Brudney, Staff Director
Mark Powden, Minority Staff Director

APPWP
Association of Private Pension and Welfare Plans

April 11, 1989

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Chairman
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Not only would the cost-of-living adjustments be enormously expensive, essentially using up any surplus that might otherwise revert to employers, but the mandatory nature of such adjustments would interfere with the traditional freedom of workers and their employers to negotiate for the level of benefits to be provided.

The mandatory cost-of-living "gift," in conjunction with the projected benefit obligation "gift," legislatively forces employers to give plan participants benefits that exceed a level for which workers and employers have negotiated.

CONCLUSION

The harsh and costly redirection of pension policy encompassed in S.685 will only serve to discourage employers from continuing or establishing benefit plans. That result would be contrary to the goals of a healthy private pension system that the Congress, the business community and employees and retirees all share. Therefore, we urge you not to proceed with consideration of S. 685 and, again, repeat our offer made during the February 9th hearing and in subsequent meetings with Subcommittee staff, to work with you to address concerns that you may have with respect to plan terminations and reversions.

7.

Sincerely,

Howard C. Weizmann
Executive Director

cc: Members, Committee on
Labor and Human Resources

U.S. Chamber of Commerce

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Albert D. Bourland
Vice President
Congressional Relations

April 24, 1989

The Honorable Howard M. Metzenbaum
Chairman
Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce and trade and professional associations, appreciates the opportunity to express its views on S. 685, the Employee Pension Protection Act of 1989. The Chamber opposes this bill because it would limit an employer's ability to recover surplus assets from a terminated pension plan after all accrued-benefit liabilities have been satisfied.

The Chamber remains committed to fostering the growth and stability of a privately sponsored, well-funded pension system. S. 685, by discouraging generous funding and, indeed, commitment to the defined-benefit system, would undermine rather than support retirement income security. The Chamber's reasons for this belief follow.

Benefit Liabilities: As you know, current law prohibits an employer from terminating a pension plan unless all benefits accrued as of the termination date are fully vested and distributed or connected to an annuity. S. 685 would transform the definition of benefit liabilities and contradict the pension promise specified in the plan document. In addition to projected plan liabilities, a substantial "cushion" is required. Such an additional benefit goes well beyond what plan sponsors originally envisioned or promised.

The goal of this "cushion," as the Chamber understands it, is twofold: first, to protect employees against economic vicissitudes, such as inflation and stock market downturns; and second, to ensure that employee expectations about retirement income are met, even when these expectations exceed the stated provisions of the plan.

With respect to the first of these goals, the Chamber shares your concern for retirement income security. However, the Chamber does not share the view that it is solely the responsibility of an employer to shield its employees from economic reality. It should be emphasized that a defined-benefit plan sponsor, by bearing the investment risk associated with plan assets and obligations, already provides a shield not available to private investors or to participants in defined-contribution plans.

Benefits under a defined-benefit plan are calculated according to a specific formula. Regardless of actuarial assumptions chosen or investment performance, the plan sponsor must provide the level of benefit prescribed by that formula. The employee gains the security of knowing, at any given time, the level of benefit to which he is entitled. In return for this predictability, the employee does not have any reasonable grounds for expecting the benefits received to be greater than those promised.

With respect to employee expectations, please note that employers that established pension plans originally expected to provide benefits to employees at the close of lifelong careers with the company. In reality, this is by no means always the case. An employee is free to leave the company, for a variety of reasons, at any point, and still receive accrued vested benefits. An employer cannot prevent an employee from exercising this freedom because of its expectations about future service.

This is as it should be in a free society. However, an employer should be entitled to similar flexibility. If it determines that maintaining a defined-benefit plan no longer is feasible or sensible in light of a changing business environment, it should be able to terminate that plan without reference to potential salary increases potentially earned over a potential period of future service.

Mandated Benefits: S. 685 would further mandate that the sponsor of a plan to be terminated provide a cost-of-living adjustment to its retirees, to the full extent of the increase in the Consumer Price Index from the date of retirement through the date of plan termination. Mandated benefits of any kind are a drastic departure from the voluntary nature of the private pension system. Worse, this mandate hurts those employers that have voluntarily chosen to provide retirement benefits to their employees. Indeed, such a requirement would discourage the formation of defined-benefit plans.

The resources that a company has available to provide benefits to its employees are not magically increased by specifying the form in which they must be spent. A mandated benefit increase to retirees may well result in decreased dollars available for active employees. It is not difficult to foresee the eruption of an intergenerational conflict that endangers the pension system as a whole.

Asset Recovery by Employer: An employer that terminates a pension plan without establishing a successor plan would be barred from recovering any surplus assets, even though valid business reasons may preclude the establishment of a new plan. For example, an employer's decision to terminate a plan may be motivated by its intention to close down a line of business or by its need for cash to keep the business in operation. Frequently, the issue of asset reversions will be tangential to a plan termination decision. S. 685 is based on the incorrect assumption that surplus assets always primarily motivate plan terminations.

Even with a successor plan, S. 685 would grant an employer the right to only such funds as may remain after fulfillment of additional obligations never promised or agreed to by the plan sponsor.

Pension Regulation: The Chamber's annual survey of employee benefits indicates that a shift away from defined-benefit plans has begun. Further, the Chamber has heard from an increasing number of its members that their attorneys and consultants have advised them to avoid defined-benefit plans. Passage of S. 685 would increase this growing trend.

The Chamber believes that the costly and unrealistic shift in pension policy represented by S. 685 will discourage employers from establishing defined-benefit plans and from sound funding of existing plans. Such a blow to the private pension system will injure workers, plan beneficiaries and society as a whole.

The Chamber respectfully requests that this letter be included in the hearing record on S. 685.

Sincerely,

Albert D. Bourland

cc: Members of the Subcommittee on Labor
James J. Brudney, Staff Director
Mark Powden, Minority Staff Director

Senator **Jeffords**. Thank you, Mr. Chairman.

I still have an open mind on this legislation and certainly want to let you know that I want to work with you and other members of the business community as well as members of the labor community and others to try and work out the best solution to this problem.

It seems to me that what we are doing is criticizing business for a policy which we have not established an answer to—we did not establish any policy as to what ought to be expected or taken care of with respect to cost-of-living, et cetera. And we just did get through some good improvements in 1987 on defining what the funding policies ought to be, and we are coming a little bit after the fact here and saying, well, this is what we wish you had done, and therefore we are going to make you do it now for those that are overfunded.

I wondered first of all, do you agree with that feeling?

Mr. **Labedz**. I think we certainly made very substantial improvements in the pension system in the 1987 legislation. I think all the parties recognized that in connection with the problem of underfunded plans that something had to be done to make each employer more responsible for the commitments that it made to its employees and not to have that be a charge against the system. And I certainly commend the Congress to the extent it played a part in that role.

Senator **Jeffords**. So I am more concerned–although I am not concerned about this legislation—as to what we are doing with respect to future use of defined benefit plans, because I think that certainly as a plan goes, they are preferable to a defined contribution plan.

What impact do you believe this legislation will have upon the formation and funding of new plans?

Mr. **Labedz**. There are a couple of different impacts. One—I am sorry I do not have the statistics—but my understanding is that among small- and medium-sized employers, a defined benefit plan just does not make economic sense anymore. There are too many administrative costs that are imposed upon the system, and those employers have backed away from it.

Even among large employers, there is a re-examination going on as to whether a company can afford to deal with the increasingly complex and burdensome rules that apply to defined benefit plans.

I personally am responsible for over 100 defined benefit plans at Textron, and I can tell you it keeps me breathless to try to keep those plans in compliance with what really is effectively semiannual re-regulation of those plans. It is a very burdensome process at this point.

Third, as I testified, I think employers will have to look very carefully at funding anything more than the minimum the law requires as a result of S. 685 if it is adopted in this particular form. Shareholders who are looking at medical costs and lots of other costs, and the ability to compete in the world marketplace, whatever the case may be, are going to say why are you providing more benefit dollars than you have actually committed to employees.

Senator **Jeffords**. I wonder whether ERIC would support the transfer of surplus assets to prefunded retiree health programs? I have been discussing this with the Administration and trying to think of some of the real unmet needs of our retirees and the utilization of the excess pension plans for that purpose.

Mr. LABEDZ. Let me ask John Vine to handle that, because I am more on the pension side.

Senator JEFFORDS. Yes, sir.

Mr. VINE. Senator, that is something we would be interested in talking to you and the other members of the committee about. Obviously, our views would depend upon the precise terms and conditions, but we would certainly be interested in discussing that.

Senator JEFFORDS. It is not a concept you are alien to at this point.

Mr. VINE. No, we are not.

Senator JEFFORDS. Okay, thank you.

Mr. LABEDZ. As one of the witnesses pointed out—let me just raise this question—we do have only so much pie to go around in terms of compensation and benefits, and to the extent that we think we are paying surplus dollars, for example, to retirees or terminated vested employees, it is a labor cost, and it may adversely affect the employer's ability to provide benefits to its existing work force, pension or medical.

Senator JEFFORDS. I am just trying to find a middle ground where we have unmet needs which everyone recognizes that somehow have to be fulfilled, if we can find something which satisfies both the retiree population as well as the business population to assist them in funding an unmet need.

Mr. VINE. Senator, I think many members of ERIC are very concerned about their unfunded liabilities for post-retirement health care, and I think for that reason, what you suggest would be of interest to many of them—provided that this can be done on a voluntary basis; that there be no requirement that they transfer so-called surplus pension assets to that. But if that is an option that would be made available, I think that would be of considerable interest to many ERIC members.

Senator JEFFORDS. Can you give me any idea what percentage of businesses we are talking about that might be interested in that kind of a concept? I mean, do we have a lot with fully-funded retirement health plans such that it would not be a likely benefit to them, or do we have very few, if any, that have well-funded retirement health plans—what are we looking at as far as a solution that might be acceptable to both sides?

Mr. VINE. I cannot claim to have conducted a survey, but my impression is that there are not a great many companies that have fully-funded post-retirement health plans, nor could there be under existing law. There just aren't very many vehicles available to fund those liabilities.

Senator JEFFORDS. Well, I do not know the extent that Textron is a Federal contractor. Can you tell us more about how the Federal Government looks at the excess assets of its contractors?

Mr. LABEDZ. Depending upon the extent to which the Defense Department is responsible for the contributions that go into the plan and has paid for them as part of the contract cost, its position is that it is entitled to that share of the surplus assets. We certainly have divisions with a mix of commercial and military business; we also have divisions with solely military business. And if we were to attempt to terminate one of those plans, I think we would see the Defense Department and the retirees showing up at our door and asking for the same dollars. The Defense Department believes it is the Defense Department's money.

Senator Jeffords. And how has that position been articulated?

Mr. Labedz. In the cost accounting regulations of the Defense Department.

Senator Jeffords. So they as an employer in a sense believe that the funds are theirs?

Mr. Labedz. Yes. In fact, let me go one step further. It was about two years ago that the Defense Department did send out letters to major defense contractors to ask them to sign agreements stating that the surplus pension assets belonged to the Defense Department.

Senator Jeffords. Thank you very much. You have been very helpful, and I look forward to working with you over the next few days and weeks.

Mr. Labedz. My pleasure, Senator. Thank you.

Senator Jeffords. I appreciate your testimony. Thank you very much.

With that, the hearing is now adjourned.

[Whereupon, at 11:50 a.m., the subcommittee was adjourned.]